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**University of Durham
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**THE IMPLICATIONS OF THE REVIVAL OF THE
OIL INDUSTRY IN AZERBAIJAN**

by

Jonathan Hemming

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INTRODUCTION

The history and development of Azerbaijan¹ is intimately tied to its relations with its great neighbours and, since the middle of last century, with the development of its major resource: oil. The advent of Russian involvement in the Caucasus with the Persian Expedition of 1722 marked the beginning of military conflict and competition between the Russian, Persian and Ottoman empires in the region. Historical Azerbaijan, squeezed between these great powers and their successor states, was partitioned along the Araxes river between the Russian and Persian empires following the Treaty of Turkmenchai in 1828,² while the western boundary between the Russian and Ottoman empires was established by the Treaty of Adrianople in 1829.³

Since then, modern Azerbaijan has seen a clutch of invasions, autonomist rebellions, re-invasions and occupations by Russian, Persian, Ottoman, and even British troops, a brief period of independence from 1918 to 1920, seizure by the Red Army, followed by seventy years of Communist rule and, after 1991, a shaky independence interspersed with a number of *coups d'état*.

Compounding its geopolitical importance as a borderland, or a meeting place of Russian, Turkic and Persian civilisations, has been the presence of oil. The very name "Azerbaijan" is popularly (but perhaps incorrectly) thought to originate from the Persian word *azer*, meaning "fire"; Azerbaijan being the "land of fires" due the fires of numerous Zoroastrian temples fed by the

¹ For ease, the term Azerbaijan will be used to refer to the territory occupied by the modern state of the Republic of Azerbaijan and not, as is sometimes the case, to a territory including the mainly Azeri-populated Iranian provinces of East and West Azerbaijan and what Azeris from the Republic refer to as 'southern Azerbaijan'. When referring to this area, or to the two territories combined, specific reference will be made.

² M. H. Ganji, "The Historical Boundaries of Azerbaijan," in K. McLachlin (ed.), *The Boundaries of Modern Iran*, (London: UCL Press, 1994), pp. 37-46.

³ T. Swietochowski, *Russian Azerbaijan, 1905-1920: The Shaping of National Identity in a Muslim Community*, (Cambridge: Cambridge University Press, 1985), pp. 7.

plentiful oil.⁴ The Apsiton peninsula, site of the present day capital, Baku, was one of the most sacred Zoroastrian sites.⁵ It was fitting then, that the world's first mechanical oil well was drilled there in 1847.⁶ One Azeri observer recalled in 1899:

*Then, in the rocky fields around Baku, oil fountains shot high up, and all watched with fascination these marvellous phenomena of nature. As the owners of the fountains were quickly piling up their millions, capitals and expertise began to flow in from everywhere, what used to be in effect the place of administrative exile, now began to bubble with life.*⁷

During this first oil boom Azerbaijan remained firmly under Russian control with the ownership of these wells increasingly falling into Russian, Western and Armenian hands.⁸ With the advent of the Soviet Union, the oil industry in Azerbaijan slipped into a slow but inexorable decline as the result of over-exploitation and under-investment.

Following World War II the focus of Soviet oil extraction moved away from the Caspian Sea to the Volga and Ural regions, and then in the 1960s towards the vast new Siberian oilfields, making the USSR the world's largest oil producer. But Azerbaijan, by the 1980s, produced a meagre 3 per cent of the Soviet total.⁹

In terms of attracting investment, Azerbaijan fared worse than most, receiving 61 per cent of the Union republics' average level of investment between 1960 and 1978, while its neighbours Georgia and Armenia received 64 per cent 78 per cent of this amount.¹⁰ Moreover, the Muslim republics of the USSR, and

⁴ T. Swietochowski, *Russia and Azerbaijan, a Borderland in Transition*, (New York: Columbia University Press, 1995), pp. 1.

⁵ N. Aliyev, "The History of Oil in Azerbaijan," *Azerbaijan International*, vol. 2, no. 2, Spring 1994, pp. 22.

⁶ *Ibid.*, pp. 23.

⁷ Hasan Bey Zardarbi, *Kaspiy*, 212, (1899), quoted in T. Swietochowski, *op. cit.*, (1995), pp. 19.

⁸ *Ibid.*, pp. 22.

⁹ *Ibid.*, pp. 179.

¹⁰ T. Swietochowski, *op. cit.*, (1995), pp. 179-80.

Azerbaijan in particular, lagged behind general Soviet living standards, with per capita income in Azerbaijan 68 per cent the Union average in 1970, compared with 81 per cent in Turkmenistan for example and 104 per cent for the non-Muslin republics.¹¹

Perhaps most damaging of all, however, was arbitrary Soviet system of price fixing. This meant that prices for most major commodities were set by central government, over which the producers and individual republics could exert little control. Oil was thus sold to the state at well below world market prices. At the end of the Soviet period, the sums involved had reached comic proportions. At the beginning of 1991, the price paid by the state for Azeri oil was increased to 120 roubles/tonne, meanwhile the cost of producing this oil stood at over 130 roubles. What is more, this same 120 roubles at contemporary prices was sufficient to buy only four kilos of meat, or one pair of shoes!¹² As a result, Soviet policy led to the depletion of natural resources with little reference, and even less benefit, to the producer republics. But, by the same token, the lack of investment left substantial energy reserves either untapped or even unexplored within the Caspian region.

In addition, Azerbaijan's population was increasing faster than in the neighbouring republics. During the decade 1979-89, Azerbaijan's population increased by about twice that of its immediate neighbours - by 16.5 per cent compared with 8.8 per cent for Armenia and 8.1 per cent for Georgia, both of which were higher than Russia whose rate was 7 per cent. The number of Azeris in Azerbaijan, however, increased by 23.2 per cent, the overall population growth figures being kept down by the substantial emigration of minority groups especially Armenians, but also Russians and Jews.¹³ Azeris became only slightly more dominant in their titular republic during this period, rising from 78 per cent of the population in 1979 to 82 per cent in 1989. Significantly though, areas within Azerbaijan became more ethnically homogeneous, while the numbers of Armenians in Azerbaijan as a whole fell by 17.9 per cent, they fell by a massive 47.2 per cent in the autonomous *oblast*

¹¹ A. McAuley, "The Soviet Muslim Population: Trends in Living Standards, 1960-75," in Y. Ro'i (ed.), *The USSR and the Muslim World*, (London: Allen & Unwin, 1984), pp. 99.

¹² *Azerbaycan Gençleri Gazetisi*, Baku, quoted in Y. Asian, *Azerbaycan, Tam Bagimsizlik Yolunda*, (Ankara), pp. 74.

¹³ P.B. Henze, "The Demography of the Caucasus According to 1989 Soviet Census Data," *Central Asian Survey*, vol. 10, no. 1-2, 1991, pp. 148-50.

of Nakhichevan, but actually grew by 18.2 per cent in Nagorno-Karabagh.¹⁴ These figures do not, of course, take into account any of the massive movements of population which have taken place since 1989 onwards with the escalation of the conflict in Nagorno-Karabagh.

At the end of 1991 then, Azerbaijan found itself thrust onto the international arena as an independent country for the second time in its history, and again subject to the same pressures from neighbouring states resulting from its geopolitical position at the cross-roads of Europe and Asia, Russia and the Middle East. Again Azerbaijan's position, astride potentially huge oil reserves, has served to render it an added importance, not only for its neighbours who, by controlling transportation routes, can earn valuable transit fees, as well as exert considerable leverage upon it, but also for nations further afield with their "capitals and expertise", which might benefit both as customers, producers and processors of this potential wealth.

Azerbaijan is thus once again the centre of much attention both from regional and world players in the international arena, and the energy resources which it currently commands are of particular significance in determining the future direction of these relations. The aim of this paper is to render an account of these relations so far and to give some idea of their likely future direction. To do this, I shall start by charting the development of Azerbaijan since independence, giving some idea of the factors which weigh upon the domestic political agenda and showing how the presence of oil has already had a major effect on domestic political events.

In order to assess the likely future effects of the presence of oil, some account must be given of the magnitude of these energy reserves and their potential. This will be done in Part Two. The next Part will deal with the major obstacles to development of Azerbaijan's oil reserves in the light of the international ramifications. In particular I shall examine the controversy over the status of the Caspian Sea, then the question of pipeline routes. To sum up, I shall then draw these factors together, giving an assessment of their likely impact on Azerbaijan's relations, in particular with its major neighbours, namely Russia, Turkey and Iran.

¹⁴ Ibid., pp. 150.

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PART ONE

AZERBAIJAN ON THE ROAD TO INDEPENDENCE

In order to assess the impact of the regeneration of Azerbaijan's oil industry, it is necessary to have some understanding of the processes leading up to that development and of the major trends in Azeri politics since the break-up of the Soviet Union.

The most important objective throughout recent Azerbaijani history and policy has been to achieve greater independence. Even before the USSR had officially ceased to exist on 31 December 1991, the former Azeri leader, Ayaz Mutalibov, had visited Ankara, establishing bilateral links with the outside world for the first time in the modern era.¹⁵

During this period of "restructuring", or *perestroika*, "the first mass resistance that could not be contained within the metamorphosing Soviet system, the crisis that precipitated the unravelling of central Soviet authority, came from an Armenian enclave in the republic of Azerbaijan."¹⁶

The hostilities which erupted in Nagorno-Karabagh in 1988 set a precedent for other ethno-nationalist struggles elsewhere which were ultimately to be the undoing of the Soviet Union. This particular conflict was also central to the formation of the Republic of Azerbaijan. Since, to this day, there has never been any real solution to the dispute, it has had an enormous impact, not only on internal politics, but in determining relations with neighbouring states and powers. Moreover, it has also had a major effect on decisions concerning the exploitation of Azerbaijan's mineral wealth.

The need for funds to help to deal with the effects of the war (such as displaced persons and damaged infrastructure), plus the need to restore stability, as well

¹⁵ A. Vassiliev, "Turkey and Iran in Caucasian Central Asia," in A. Ehteshami (ed.), *From the Gulf to Central Asia: Players in the New Great Game*, (Exeter: University of Exeter Press, 1994), pp. 139.

¹⁶ R.G. Suny, *Revenge of the Past: Nationalism, Revolution and the Collapse of the Soviet Union*, (Stanford: Stanford University Press, 1993), pp. 132.

as the desire to re-arm in order to prosecute the war more effectively, have given added urgency to decisions on the future development of Azerbaijan's oil reserves, on the award of contracts to oil companies and on the choice of routes for transporting the oil. However, there are two sides to this development. As will be seen below, the presence of oil in the region may also have a potential for encouraging peace. Peace and concomitant stability in Azerbaijan have, however, so far been hard to achieve. The already low standards of living, together with the familiar crippling consequences of the transformation from a centralised to a market economy, added to the effects of a brutal civil war which produced over one million internal refugees, has led to extreme economic dislocation.¹⁷ According to the IMF, the Azerbaijan economy since the late 1980s, has:

*experienced severe external shocks. These included the break-up of the USSR and the associated disruptions in trade and financial links, the conflict over Nagorno-Karabagh, and the deterioration of Azerbaijan's terms of trade as prices of natural gas and other imports rose to world market levels and transportation costs rose due to closure of trade routes through Georgia and Chechnya. The resulting decline - real GDP fell by about 60 per cent in 1990-94 - has been among the largest in the transition economies.*¹⁸

Added to this, government financial policies, "largely inconsistent with achieving economic stability", combined to produce consumer price increases of 1,800 per cent in 1994 and monthly inflation in excess of 50 per cent at the end of that year.¹⁹ Such economic collapse was not only a product of the upheavals in Azerbaijan but was also a factor which reinforced and entrenched existing economic and political problems.

This turmoil, which began with the eruption of the Nagorno-Karabagh dispute in February 1988 (well before the break-up of the Soviet Union in 1991), not only preceded similar events elsewhere but, since the dispute has yet to be fully resolved, has also been more sustained. Events in Azerbaijan have also been exceptional in a number of other respects. There were large demonstrations in Baku throughout 1988 and in August of that year the only genuine mass

¹⁷ *The Times*, 14 December 1994. See also *Humanitarian Assistance in the Republic of Azerbaijan*, Save the Children Report, Azerbaijan Field Office, Baku, March 1996.

¹⁸ *IMF Survey*, 15 April 1996.

¹⁹ *Ibid.*

opposition group in the Muslim republics of the Soviet Union, the *Azerbaijani Halk Cephesi* (Peoples' Front of Azerbaijan, PFA), was formed. Further demonstrations broke out at the end of 1989 along the Iranian border; border fencing was pulled down in protest at the ban on Azeris visiting relatives and graves on the other side. There were also calls for unification of both Azerbaijanans.²⁰ This was followed by attacks on Armenians in Baku and excesses were committed by both communities throughout the country. It culminated in a confrontation between the PFA and Soviet forces trying to wrest back power in the capital, resulting in the deaths of 168 civilians with another 400 missing.²¹

After the failed Moscow *coup d'etat* of 19 August 1991, Azerbaijan became the first of the USSR's Muslim republics to declare independence, issuing the "Declaration on Restoring the State of Independence of the Republic of Azerbaijan" on 30 August 1991,²² and was first to be recognised by the outside world, initially by Turkey, on 9 November 1991.²³ Despite Azeri president Ayaz Muttalibov's apparent nationalist leanings, his alleged initial endorsement of the communist-inspired 19 August *coup*, his hasty commitment to join the Commonwealth of Independent States (CIS) and his clear pro-Russian sympathies, cost him much support.

At the same time, however, in his home territory of Nakhichevan, where he had received 95 per cent of votes in the 1990 elections, Haydar Aliyev, ex-KGB and Brezhnev-era party boss, was forcing the pace of change by disbanding the local communist party and nationalising its property. Thus pressured to follow suit, on 14 September 1991, in its shortest-ever session, the Communist Party of Azerbaijan voted to disband itself.²⁴ Despite this political manoeuvring, Muttalibov was unable to retain power and, as seems to be the fate of Azeri politicians, his "nemesis became the Nagorno-Karabagh conflict, the catalyst for the rise of the national movement, which was now becoming a time bomb."²⁵

²⁰ T. Swietochowski, *op. cit.*, (1995), pp. 202-03.

²¹ *Ibid.*, pp. 205.

²² J.M. Landau, *Pan-Turkism, from Irredentism to Co-operation*, (London: Hurst & Co., 1995), pp. 197.

²³ *Ibid.*, pp. 213.

²⁴ T. Swietochowski, *op. cit.*, (1995), pp. 217.

²⁵ *Ibid.*, pp. 218.

An Armenian offensive beginning at the end of January 1992, aimed at opening a corridor between Nagorno-Karabagh and Armenia through the town of Lachin and at capturing the town of Shusha, revealed the dismal state of Azeri forces. This was blamed on Mutalibov's failure to organise a national army which was still only 500 strong at this point.²⁶ The final straw came as reports and pictures began to filter back of massacres committed by Armenian forces in the town of Khojali, where over 450 Azeri civilians were killed.²⁷ Mutalibov was thus forced to resign on 6 March 1992. Yaqub Mamadov was to have remained provisional president pending elections, but when the town of Shusha fell to the Armenians, Mutalibov attempted a counter *coup*, leading to the removal of both of them. The election, on 7 June, from which Haydar Aliyev was barred due to an upper age limit set at sixty-five, was won by the chairman of the PFA, former dissident and Arabic scholar, Abdulfaz Elchibey.

The new president, during his rule which lasted almost one year, attempted to open a new era for Azerbaijan. He began by promising closer links with Turkey and by vehemently denouncing Iran, accusing it of being a "totalitarian regime which covers itself in Islamic slogans,"²⁸ and arousing Iranian sensitivities over its sizeable Azeri minority by suggesting that, "as an independent state rises in the north of Azerbaijan, it will make it easier for freedom to grow in the south."²⁹ Almost immediately after this, Elchibey stepped up negotiations with foreign oil companies for the development of a number of large Caspian oilfields, promising that money earned from these resources would win the war with Armenia.³⁰ On the other hand, in his fiefdom of Nakhichevan, Haydar Aliyev negotiated a deal with the Iranian government to receive food and energy supplies,³¹ and also managed to obtain a US\$ 100 million loan from Turkey for the hard pressed region.³²

²⁶ *Times*, 29 January 1992, 8 February 1992, and 15 March 1992.

²⁷ *Ibid.*, 1 March 1992, and 2 March 1992.

²⁸ Quoted in *The Times*, 9 June 1992.

²⁹ *Azadliq*, Baku, 19 July 1991, quoted in T. Swietochowski, *op. cit.*, (1995), pp. 222.

³⁰ *The Times*, 30 June 1992.

³¹ *The Financial Times*, 25 August 1992.

³² T. Swietochowski, *op. cit.*, (1995), pp. 215.

The Pan-Turkist sentiments of Elchibey, in contrast, were short on bringing concrete results.³³ Even as President Özal of Turkey, who shared similar sympathies with Elchibey, was recommending Turkish military intervention in the conflict, the Turkish prime minister, Süleyman Demirel, was discounting all such possibilities.³⁴ As Elchibey withdrew Azerbaijan from the CIS, Russia retaliated by raising import duties, causing massive inflation and further dislocation in the economy. Such moves also led Moscow to ease restrictions on the movement of arms and mercenaries into Armenia. Meanwhile, Turkey was beginning to realise the burdens that too close an alliance with Azerbaijan could bring - over-antagonising Russia was just too high a price. Neither were signs coming from America encouraging: a Congressional ruling (Title IX, Section 907 of the 1992 Freedom Support Act) prohibited, and still prohibits, assistance:

*to the Government of Azerbaijan until the President determines, and so reports to Congress, that the Government of Azerbaijan is taking demonstrable steps to cease all blockades and other offensive uses of force against Armenia and Nagorno-Karabagh.*³⁵

Thus, while President Özal still spoke of a military alliance between Turkey and Azerbaijan on a visit to Baku on 14 April 1993, the idea died with him three days later.³⁶ President Elchibey was also soon to depart to another place, though in his case it was to exile in Nakhichevan. Like his predecessor Mutalibov, lack of success, or indeed outright failure, in Nagorno-Karabagh proved to be his undoing. Despite efforts to reach a cease-fire, an Armenian offensive over the winter of 1993 resulted in further losses for the Azeri side in the conflict. A corridor from Armenia through Lachin was finally opened up, allowing further reinforcement of the Armenian forces in Nagorno-Karabagh. While Armenian troops were advancing on all fronts and with desertions amongst Azeri forces reportedly widespread, Baku was ineffectually adorned in FFA slogans stating "Nagorno-Karabagh will always be Azerbaijan", and "Defend the Motherland to the last drop of your blood", only these signs were

³³ One of the few was the reinforcement of Turkey's border with Nakhichevan, which successfully deterred Armenian attacks on the province, *The Times*, 8 April 1993.

³⁴ Ibid.

³⁵ Quoted in *USAID Country Profile: Azerbaijan*, February 1995. Pressure from US oil companies has succeeded in opening loopholes in Section 907, allowing some US aid through to Azerbaijan, (*Houston Chronicle*, 26 September 1996).

³⁶ *The Times*, 15 April 1993.

written in the recently adopted Latin script of Turkey, and so were unintelligible to all but a few people.³⁷

Elchibey then attempted to remove one of his own commanders, the 35-year-old Suret Hüseynov, charging him with responsibility for the battlefield reverses. The former factory manager and reputed millionaire Hüseynov,³⁸ commanding a private army of some 3,000 troops, then moved against the government, taking over the second city, Ganja. After demanding that Russian troops which were still stationed in Ganja quit the city to avoid being caught up in the conflict, the government decided to take on the rebels on 4 June. When this also ended in humiliating defeat for the government and the loss of seventy lives, Hüseynov's militia leisurely moved towards the capital, forcing the government to make concessions and Elchibey to flee.³⁹ Portentously, Haydar Aliyev was now brought to Baku and elected speaker of the Milli Meclis (National Assembly) on 15 June, with presidential powers due to the absence of Elchibey. Aliyev appointed Hüseynov as head of the defence, interior and security ministries, and as prime minister and 'supreme commander' of the armed forces.⁴⁰

This *coup* coincided with what was to be the culmination of a large oil deal with a consortium of Western companies. Elchibey had been due to travel to London to sign the agreement on 2 July. Despite his forced departure instead to Nakhichevan on 18 June, the eight foreign companies involved (BP, Statoil, Amoco, Pennzoil, McDermott, Unocal, Ramco and TPAO), paid US\$70 million 'good faith money' to the government in order to continue negotiations.⁴¹ Less than a week later the new Azeri government responded by cancelling the deal and arguing for a re-negotiation on more favourable terms for the Azeri side. It also refused to return the money.⁴²

³⁷ Ibid., 14 April 1993.

³⁸ *Reuters*, 27 March 1997.

³⁹ *The Financial Times*, 17 June 1993.

⁴⁰ Ibid., 1 July 1993.

⁴¹ Ibid., 23 June 1993.

⁴² Ibid., 28 June 1993, and 13 August 1993.

Haydar Ali Rizaoglu Aliyev was born on 10 May 1923,⁴³ although there does seem to be some doubt about this date. He did join the KGB in 1945, however, and rose to be its head in Azerbaijan in 1967. He became First Secretary of the Azerbaijani Communist Party in 1969 and was a member of Leonid Brezhnev's inner circle. He became a full member of the Soviet Politburo under Andropov in 1982 but was dismissed by Gorbachev in 1987 and branded a corrupt *anti-glasnost* hard-liner.⁴⁴ After charting a come-back from his native Nakhichevan, he consolidated his position with a referendum of no confidence in Elchibey on 29 August and presidential elections on 3 October 1993.⁴⁵ Although he insists that he "didn't want to be president" but that people "asked" him,⁴⁶ Aliyev has proved to be a skilful and wily politician who has brought the stability required by the major oil companies and managed to balance the competing international forces that historically have threatened the republic.

After successfully forcing the renegotiation of the oil contracts, Aliyev brought Azerbaijan back into the CIS, but without inviting back Russian troops. Relations with Iran improved greatly at the cost of ties with Turkey and politicians there were forced to take a more realistic view of their limited capabilities, especially in the face of renewed Russian interest in the region. One of Aliyev's first acts was to insist on the resignation of Sabit Bagirov, the head of the State Oil Company of the Azerbaijan Republic (SOCAR) who had negotiated the previous oil contract which Elchibey was to have signed in London. He was replaced with a little known geologist, Natic Aliyev (no relation), who was stripped of decision-making powers which were transferred to parliament, now firmly under Haydar Aliyev's control.⁴⁷ By November an 'agreement in principle' with the BP-led consortium had been reached and a further US\$250 million gained as a signature bonus, with another US\$250 million to be paid upon the finalisation of an export-pipeline agreement.⁴⁸

⁴³ A.L. Altstadt, *The Azerbaijani Turks: Power and Identity under Russian Rule*, (Stanford: Hoover Institution Press, 1992), pp. 177.

⁴⁴ L. Chorbajian, P. Donabedian, and C. Mutafian, *The Caucasian Knot, the History and Geopolitics of Nagorno-Karabagh*, (London & New York: Zed Books, 1994), pp. 17.

⁴⁵ T. Swietochowski, *op. cit.*, (1995), pp. 225.

⁴⁶ Quoted in B. Blair, "Interview with President Haydar Aliyev," *Azerbaijan International*, vol. 2, no. 2, 1994.

⁴⁷ *The Financial Times*, 13 August 1993.

⁴⁸ *Ibid.*, 2 November 1993.

In the new year of 1994, the partly state-owned Russian oil company Lukoil⁴⁹ started to be mentioned as a possible partner in the deal. This coincided with renewed Russian efforts to secure peace in the conflict in Nagorno-Karabagh. The Armenian forces had taken advantage of the turmoil of the *coup* to make major advances, taking the last Azeri-held towns in the Karabagh as well as the towns of Agdam, Cebrayil and Fizuli in Azerbaijan proper. After peace efforts in the autumn also failed, a surprise attack was launched by the Azeris in October, reportedly spearheaded by some 1,000 mujahideen from Afghanistan, but to no avail. In December a new offensive was launched, resulting in heavy casualties, but few gains.⁵⁰ At the end of this last effort to secure a military solution to the conflict, Aliyev visited Ankara, Paris and London to put forward the Azeri case on Nagorno-Karabagh. He also speeded up negotiations with the companies of the nascent oil consortium by handing responsibility for negotiations from parliament back to SOCAR. Just as this occurred, a Russian-brokered cease-fire was announced which, although broken on numerous occasions, was at least the beginning of the end of widescale hostilities.⁵¹

Thus on 20 September 1994 the so-called "contract of the century", was signed. The thirty-year US\$8,000 million contract between Azerbaijan, represented by SOCAR, and a consortium of ten foreign companies to develop the Azeri, Chirag and Güneşli (ACG) oilfields was a major landmark in the development of Azerbaijan. The companies included Amoco, Unocal, McDermott and Pennzoil of the US, BP and Ramco of the UK, Statoil of Norway, Lukoil of Russia, TPAO of Turkey and Delta of Saudi Arabia (see Appendix 1). The signing of such an agreement with these major corporations installed confidence in smaller companies, both in the oil industry and outside it, increasing their willingness to make investments in Azerbaijan. The presence in the consortium of such major companies, from such diverse countries of origin, gave each of those countries a vested interest in the future of Azerbaijan, thus forming a firmer basis for stability and offering a safer guarantee for continued independence. "Azerbaijan has no lobby in any Western country. But when the oil agreement is signed, it will have economic relations with these countries," predicted Leyla Yunusova, a former deputy defence minister.⁵² Aliyev also gained a more ready access to world leaders; days after the signing he was in America to address the UN general assembly.

⁴⁹ The government of the Russian Federation holds 38.58 per cent of Lukoil shares.

⁵⁰ *The Financial Times*, 7 March 1994.

⁵¹ *Ibid.*, 21 February 1994 and 22 February 1994.

⁵² Quoted in *Ibid.*, 7 March 1994.

He also met US president Bill Clinton to discuss the implications of the oil deal and to put forward Azerbaijan's view of the hostilities in Nagorno-Karabagh, after which he stated, "I'm very confident, now more than ever, that Azerbaijan is closer to achieving a peaceful resolution of the conflict with Armenia."⁵³

The day after the signing of the oil contract, however, four high-ranking prisoners, including the former defence minister, Rahim Gaziyeu (who later turned up in Moscow), escaped from custody in the security ministry; noting the timing of this event, Haydar Aliyev remarked, "I don't think it is pure coincidence."⁵⁴ Then, on the same day that Aliyev was giving his speech at the UN, two of his close allies, his security chief, Shemsî Rahimev, and the deputy parliamentary chairman, Afîyeddin Jelilev, were murdered. When three members of OMON, the interior ministry troops, were arrested for the killings, OMON troops took the general prosecutor, Ali Umarov, hostage and demanded the release of their colleagues.⁵⁵ Other OMON units took control of the airport and administrative buildings in Ganja and there was also a grenade attack on a crowded market in Baku in which 20 people were injured. Aliyev, now returned, declared a state of emergency and called for popular demonstrations of support in which over 20,000 people participated.⁵⁶ Despite their declarations of support for the existing government, both Roshvan Javadov, the interior minister, and Suret Hüseynov, the prime minister and erstwhile *coup* leader, were dismissed from office, slipping quietly into exile with Russian assistance amidst accusations that the *coup* was inspired with backing from Russia.⁵⁷

⁵³ Quoted in B. Blair, "President Haydar Aliyev and the Oil Contract of the Century," *Azerbaijan International*, vol. 2, no. 4, Autumn 1994.

⁵⁴ Quoted in C. H. Fairbanks, and E. Alekberov (eds.), "Azerbaijan and the Ominous Rumblings over Russia's 'Near Abroad'," *Azerbaijan International*, vol. 2, no. 4, Autumn 1994.

⁵⁵ T. Swietochowski, *op. cit.*, (1995), pp. 227; *The Financial Times*, 3 October 1994, and 4 October 1994.

⁵⁶ *The Times*, 5 October 1994, and 6 October 1994.

⁵⁷ *Briefing*, 10 October 1994; R.V. Barylski, "Russia, the West, and the Caspian Energy Hub," *Middle East Journal*, Spring 1995, pp. 223-4. Hüseynov was extradited back to Baku at a time of improving Russian-Azeri relations in March 1997 to face charges of treason and armed rebellion and a possible death penalty, (*Reuters*, 27 March 1997).

Haydar Aliyev thus succeeded in largely overcoming opposition and removing the major obstacles to Azerbaijan's development. The best hope for development, as well as the best chance of achieving some relief from the effects of a disastrous war, hinged on oil. Oil resources could not be developed without stability, while stability could not be achieved while the war raged (especially with its appetite for devouring Azeri leaders). But the war could not be stopped while Russia remained excluded from all influence (the same could be said for Iran, though to a lesser extent). Bringing Russia into the conundrum, by giving it a stake in Azerbaijan's development, gave it an interest in halting the war in the Karabagh.

Still the major power in the region, Russia could then put pressure on Armenia, gain at least a temporary halt to hostilities and open the way for the oil deals that held the key to Azerbaijan's future. Achieving independence was more a matter of ensuring interdependence than it was of remaining aloof from historically important neighbouring nations. Aliyev's success was in recognising this fact. "What should we do?", he said at the time, "Should we simply continue to annoy it (Russia)? She is a great power and will continue to be. She has been involved in the fate of Azerbaijan for over two centuries. She must be at the centre of our policies."⁵⁸

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⁵⁸ Quoted in *The Financial Times*, 7 March 1994.

PART TWO

THE OIL

Oil in Azerbaijan

The presence of oil in Azerbaijan has thus been one of the major determining factors in its most recent history. But in order to establish the true implications of its presence in terms of Azerbaijan's relations with its most important international partners, we must first establish the nature and extent of these reserves and assess the character and magnitude of the major obstacles to oil extraction, export and sale. It has been claimed that:

*the Soviet regime deliberately prevented the Caspian region's energy resources from being developed, ... deprived Azerbaijan, Kazakhstan and Turkmenistan of the opportunity to reach for higher living standards; ... gave priority to oil and gas fields inside the Russian Federation, directed new capital into Russia's western Siberian fields, and built pipelines that linked them to Western markets.*⁵⁹

This shift in production was as much tied to technological considerations as it was to political reasoning. As the onshore fields became increasingly depleted, the remaining Caspian Sea oil deposits lay in deep water, difficult to extract due to lack of technological sophistication,⁶⁰ and thus more problematic than the deposits lying underground in Siberia. Similarly, by the late 1980s, more than 70 per cent of wells in Azerbaijan had been in use for more than thirty years and so were in desperate need of restoration. Short of investment capital, the Soviet Union displayed a disposition for directing available capital away from the Caspian basin. During the last three "five-year plans", not a single Azeri oil well was discovered and put into service.⁶¹ Thus, oil production in Azerbaijan fell steadily from 14.7 million tonnes per year in 1980 to 11 million

⁵⁹ R.V. Barylski, *op. cit.*, pp. 128.

⁶⁰ M.J. Sagers, "The Energy Industries of the Former USSR: A Mid-year Survey," *Post-Soviet Geography*, vol. 34, no. 6, 1993, pp. 344.

⁶¹ *Halk Gazetisi*, Baku, 30 August 1991, quoted in Y. Asian, *op. cit.*, pp. 75.

tonnes in 1992.⁶² At the time, the director of Azerbaijan's state oil company, SOCAR, stated that he expected oil production to level out in 1993 and begin to rise again from thereon.⁶³ In fact, oil production was only beginning to level out in 1996, with 9.1 million tonnes produced in the year, compared with 9.16 million tonnes in 1995.⁶⁴

Despite these figures most observers remain optimistic. The onshore deposits in Azerbaijan, including some of the oldest oilfields in the world on the Apsiton peninsula, may still contain substantial quantities of oil. According to one report, this may even amount to as much as 40 per cent of their original reserves.⁶⁵ Such deposits, analysts argue, are being under-exploited due to outdated machinery and lack of equipment, rather than depletion of reserves. To this end, a number of agreements have been signed with foreign contractors for the renewal and rehabilitation of these existing onshore fields. These include: the Turkish companies Atilla Dogan Petrosan and Türkiye Petrolleri Anonim Ortakligi (TFAO) which are working on oilfields in the south-west and north-west of the republic respectively; Texaco which has signed a protocol of understanding to explore older fields in the lower Kura valley near the border with Georgia,⁶⁶ and the British company Ramco which has proposed a joint development of the Muradkhanli onshore field, discovered in 1974 but whose production then soon fell off due to technical difficulties.⁶⁷

By far the largest energy reserves are to be found offshore, however, accounting for about 80 per cent of Azeri production. The Caspian basin as a whole already has proven oil reserves of 27,500 million barrels and the potential to yield 40-60,000 million barrels.⁶⁸ As has already been noted, large areas of the Caspian Sea have yet to be properly surveyed for oil. For financial, as well as political, reasons the Caspian littoral states most eager to develop

⁶² M.J. Sagers, *op. cit.*, pp. 344.

⁶³ *Interfax News Report*, 12-19 February 1993, pp. 12.

⁶⁴ *Reuters*, 6 January 1997.

⁶⁵ *BBC SWB/SU*, 19 February 1993, pp. 13.

⁶⁶ M.J. Sagers, *op. cit.*, pp. 344, *The Financial Times*, 5 February 1993.

⁶⁷ N. Aliyev, "Oil Development in Azerbaijan Since Last Year's Oil Exhibition," *Azerbaijan International*, vol. 4, no. 2, Spring 1996.

⁶⁸ T.D. Adams, "Political Stability: The Key to Caspian Exports," *Petroleum Economist*, September 1996, pp. 44. This compares with Kuwait's proven oil reserves of 97,000 million barrels, *The Economist*, 15 February 1997.

these reserves have been Kazakhstan and Azerbaijan. Of the other states bordering the Caspian Sea, Iran has large oil reserves elsewhere, and has yet shown little interest in the immediate development of its Caspian energy reserves; similarly Russia is presently prioritising its West Siberian fields and has made only the most tentative steps towards oil exploration in its section of the Caspian basin. The technical difficulties of extracting Caspian oil mean that foreign expertise and financial investment will continue to be necessary for the foreseeable future, a fact concerning which both Iran and Russia, each for their own reasons, have certain reservations. Turkmenistan, for its part, is more concerned to develop its substantial natural gas reserves while avoiding dependence on outside help. Although there are plans to explore the Turkmen sector of the Caspian Sea for oil,⁶⁹ the Turkmen government is anxious that the row over the sea's status be cleared up before any deals can be reached.⁷⁰

For both Kazakhstan and Azerbaijan, however, probably the biggest export potential comes from their hydrocarbon energy reserves and both have been keen to develop this resource. To this end, both have followed similar paths. The Kazakhstancaspiishelf consortium, which includes seven Western companies and the Kazakh state oil company, has contracted to develop energy reserves in the Kazakh sector of the Caspian Sea. After recently completing a US\$200 million seismic survey of the area though, the consortium refused to confirm whether earlier estimates of 10,000 million tonnes of oil reserves were accurate.⁷¹

In the Azeri sector of the sea, the only accurate figures for the quantities of oil present come from the fields already being worked by the Azerbaijan International Operating Company (AIOC) consortium of companies (see Appendix 1). According to figures available from these sources, proven reserves in the ACG contract area amount to 4,000 million barrels of oil.⁷² The Shah Deniz block, meanwhile, is said to contain approximately 200 million tonnes of oil (1,500 million barrels) plus natural gas condensate;⁷³ the

⁶⁹ A. Akimov, "Oil and Gas in the Caspian Sea Region: An Overview of Co-operation and Conflict," *Centre for Post Soviet Studies, Occasional Paper*, 11 June 1996, pp. 3; *BBC SWB/SU*, 7 June 1996.

⁷⁰ *Reuters*, 12 March 1997.

⁷¹ *New Europe*, 18-24 August 1996, pp. 43.

⁷² T.D. Adams, *op. cit.*, pp. 44; *Daily Petroleum Monitor*, 17 February 1997.

⁷³ *The Financial Times*, 5 June 1996.

Lenkoran Deniz project is estimated to contain 40 million tonnes of oil (300 million barrels),⁷⁴ while the Karabagh and Inam fields are each thought to contain more than 1,000 million barrels.⁷⁵ These amounts are still only estimates of the amount of oil present; actual amounts could be lower or even exceed the figures mentioned.

The ACG contract was to refurbish and extend a previously existing field. Shah Deniz, meanwhile, is an "unexplored structure",⁷⁶ the contract for which is for "exploration and development"⁷⁷ of the field; the Karabagh contract similarly specifies a three-year exploratory period, to be followed by development and production, "should oil be found".⁷⁸ The prospect that oil and/or gas might not be found in these fields, however, is slight. In the words of AIOC president Terry Adams, "exploration risk is low", and while the Soviets faced certain technical problems in order to develop these fields, for AIOC this requires "only conventional technology".⁷⁹

The first of the major oil extraction projects to come on stream will be the ACG fields run by AIOC. The first phase of the AIOC programme involves offshore field appraisal (confirmation of available reserves, plus geotechnical, seabed and environmental surveys), refitting and constructing offshore production facilities and, thirdly, the "reactivation of existing export infrastructure to take ACG early oil to the Black Sea."⁸⁰ This first phase is to be completed by the third quarter of 1997. "Early oil" is the term used to refer to the first amounts of oil to be produced from the existing and soon to be completed oil platforms which will generate the initial return on the companies' investment in the first years of field development. The amount of early oil is envisaged to rise gradually to a potential capacity of 210,000 barrels a day (b/d). Once the main oil comes on stream, this could rise to as much as 700,000 b/d.⁸¹ Before any of

⁷⁴ *Turan News Agency Report*, Baku, 24 May 1996; *BBC SWB/SU*, 31 May 1996.

⁷⁵ *Reuters*, 10 June 1996; *Interfax*, 12 January 1997.

⁷⁶ *Foreign Economic Relations*, (Baku: Sharg INA, 1996), pp. 18.

⁷⁷ *Ibid.*, pp. 17.

⁷⁸ Interview and correspondence with senior Agip official, Baku, 30 July and 8 September 1996.

⁷⁹ T.D. Adams, *op. cit.*, pp. 44.

⁸⁰ *Ibid.*, pp. 45.

⁸¹ *Ibid.*, *The Financial Times*, 21 September 1994.

this potential can be realised, however, there are a number of geopolitical problems to be overcome.

The Status of the Caspian Sea

One of the problems which has impeded the development of the oilfields in Azerbaijan has been the uncertain status of the Caspian Sea. In recent years the question of the status of the Caspian Sea has gained an added importance. Whether it is in fact a sea, or in reality a giant lake, was, until the break-up of the Soviet Union, a largely abstract question. Since then, the independence of three new states bordering the Caspian has thrown into doubt existing treaties concerning its status which were agreed essentially between two states, Iran and Russia (later the USSR).

In particular, the issue of the right to extract the sea's mineral resources has been the greatest bone of contention, involving matters fundamental to the national sovereignty and future development of the newly independent littoral states, and also key issues for Russia in its unfolding relations with its former attendant republics. But on closer examination, the very insolubility of this question in itself provides, as long as each state is prepared to stick by the rules, the basis of a practical *modus vivendi* for all the Caspian riparian states.

The Caspian Sea is an enclosed body of salt water approximately 700 miles north to south and 250 miles east to west, With a maximum depth of 1,025 metres and an average water volume of 80,000 km³ it is the world's largest inland body of water.⁸² It is bordered by Iran to the south, Azerbaijan to the west, Turkmenistan to the east, Kazakhstan to the north and east and Russia to the north and west. As well as the oil reserves already discussed, there are also important fisheries resources, including the beluga sturgeon whose roe is used for caviar. Besides the jurisdictional problems over the right of extraction of its resources, there are connected environmental and military issues which are important when considering the Caspian's status.

The first relevant treaty concerning the Caspian is the aforementioned Treaty of Turkmenchai of 1828 which delineated the Russian and Persian frontiers. The

⁸² F.M. Jafarov, *Review of the Environmental Conditions Associated with the Chirag Oilfield*. Report to BP and Statoil, quoted in L. Ireland, "The Caspian: Hydrobiological Survey of the Chirag Oilfield Area," *Azerbaijan International*, vol. 2, no. 3.

treaty granted rights of passage to Russian and Iranian merchant ships on the Caspian Sea, but ceded the exclusive right to maintain a navy on these waters to Russia.⁸³

Subsequent treaties affecting the management of the Caspian Sea during the Soviet era were signed between the Russian Socialist Federal Soviet Republic (RSFSR) and Iran in 1921,⁸⁴ and between Iran and the USSR in 1935⁸⁵ and 1940.⁸⁶ The position stated in the 1935 treaty and repeated in 1940 was that both parties regarded the Caspian as "a Soviet and Iranian Sea" with exclusive control vested in the two governments.⁸⁷ None of the treaties specifically refers to the division of territorial waters between the two states, however, nor is there any mention of the exploitation of the natural resources of the continental shelf. The only delineation of the Caspian of any kind was in provisions in the 1935 and 1940 treaties according to which each state reserved the right to fish in coastal waters up to ten nautical miles from the shore, though this area was not defined as a territorial sea nor even as a fisheries zone.⁸⁸

Such ambiguities have been compounded by the break-up of the Soviet Union and the addition of the three new Caspian littoral states: Azerbaijan, Kazakhstan, and Turkmenistan. With no established mechanism for governing the waters of the Caspian basin, the parties have appealed to both precedent and international law to justify their positions.

The position held by these new states is that the Caspian ought to be considered an international sea, with sovereignty of its territorial waters extending to the sea bed and subsoil and also the resources thereof (plus the airspace above), as set out in the Geneva Convention on the Territorial Sea and the Contiguous

⁸³ A. Maleki, "Iran's Northeastern Borders, from Sarakhs to Khazar, (the Caspian Sea)," in McLachlin (ed.), *op. cit.*, pp. 14.

⁸⁴ 1922 *League of Nations Treaty Series*, pp. 401-13. Treaty of Friendship between RSFSR and Persia, signed 26 February 1921.

⁸⁵ 1937 *League of Nations Treaty Series*, pp.301-33. Treaty of Establishment of Commerce and Navigation between Iran and USSR, signed 8 June 1935.

⁸⁶ 144 *British and Foreign State Papers*, pp.419. Treaty of Commerce and Navigation between Iran and the USSR, signed 25 March 1940.

⁸⁷ *League Of Nations Treaty Series*, pp. 330-31.

⁸⁸ G. Englefield, "A Spider's Web: Jurisdictional Problems in the Caspian Sea," *IBRU Boundary and Security Bulletin*, Autumn 1995, pp. 30.

Zone of 1958, and the United Nations Convention on the Law of the Sea of 1982.⁸⁹ This would imply that littoral states would have full rights over territorial waters up to 12 nautical miles from the coast, the right to assert a contiguous zone up to 24 nautical miles and distinct rights, including the right to exploit mineral resources, within an Exclusive Economic Zone (EEZ) of 200 miles and over the Continental Shelf beyond 12 miles.⁹⁰

Under international law there is also a good case for arguing that the same rules should also apply to inland seas:

*when the shores of a land-locked sea belong to two or more countries, and there is no agreement to the contrary fixing the limits of their respective boundaries, the sovereignty of each must be respected in the zone of its territorial waters, and the legal regime in the central part is then similar to that on the high seas.*⁹¹

Thus the riparian states of such an inland sea would have the same rights as they would if the sea were not enclosed. In either case, of the Caspian being seen as part of the high seas, or of it being judged to be an inland sea in which the international law of the sea should apply, similar methods of demarcation would be utilised.

As EEZs of the Caspian coastal states would clearly overlap (the body of water being only 250 miles wide), agreement over the demarcation of such zones would need to be established. In these cases there are a number of methods of deciding the issue of the overlapping of EEZs. By far the most common method of deciding such boundaries, however, is by their being set equidistant from the opposing shores. Despite the 1982 UN Convention, making "vague delimitation formulae and references to an 'equitable solution'", that is a solution taking into account the various interests of the parties involved, the overwhelming majority of such cases, both before and after 1982, have been decided according to the principle of equidistance.⁹² Even if an "equitable

⁸⁹ See H. Lauterpacht (ed.), *Oppenheim's International Law*, vol. 1, 1992, pp. 573.

⁹⁰ See E.D. Brown, *Sea Bed Energy and Minerals: The International Law Regime*, (Dordrecht: Martinus Nijhoff, 1992), pp. 9-13; G. Englefield, *op. cit.*, pp. 31.

⁹¹ Colombos, *International Law of the Seas*, (1967), pp. 191, quoted in G. Englefield, *op. cit.*, pp. 33.

⁹² E.D. Brown, *op. cit.*, pp. 330.

solution" were to be applied, according to an International Court of Justice ruling, "[i]n opposite state situations, where the distance between the two states does not exceed 400 miles, geological or geomorphological factors are irrelevant to the delimitation of the continental shelf."⁹³ So even if an "equitable solution" were to be applied to the delimitation of the Caspian, the right of the younger Caspian states of Azerbaijan, Kazakhstan and Turkmenistan to extract the sea's mineral resources should still be protected.

If, however, the Caspian is considered to be a lake, its status is quite different. For lakes bordered by more than one state, international boundaries are normally established by agreement with the parties concerned and the international law of the sea does not apply.⁹⁴ This is the view most frequently put forward by Russia, arguing that the Caspian "lake" is a "condominium" in which rights are shared by all the littoral states, and which cannot be exploited by any one of them without agreement from all.

In other similar circumstances, the matter is often governed by special treaties, examples of which include those covering: Lake Constance which is bordered by Austria, Switzerland and Germany; Lake Geneva between Switzerland and France, and the lakes of Huron, Erie and Ontario which are divided between Canada and the US.⁹⁵

In all these cases, though, the agreement between the parties involved the partition of the whole area into territorial zones exclusively under the sovereignty of the relevant coastal state, although common regimes dealing with matters of mutual interest, such as environmental management, are often established. This exclusive division in nearly all cases has followed the principle of drawing a median line between the concerned states based on the length of coastline. This is the case in the 1816 treaty which divided Lake Geneva between Switzerland and Sardinia, the 1867 Treaty of Bregenz dividing Lake Constance and the various treaties between the US and Great Britain dividing the Great Lakes.⁹⁶ Thus, even if the Caspian were considered to be a lake, precedence dictates that the division be undertaken according to

⁹³ "The Gulf of Maine Judgement," *I. C.J Reports 1984*, pp. 300, para. 113, quoted in E.D. Brown, *op. cit.*, pp. 358.

⁹⁴ H. Lauterpacht, *op. cit.*, pp. 590.

⁹⁵ *Ibid.*

⁹⁶ *Ibid.*

median lines and length of coastline. Such a judgement would also favour the position of the governments of Azerbaijan, Kazakhstan and Turkmenistan.

The dispute over the Caspian, then, first of all concerns the issue of whether it is a sea connected to international waters, and thus subject to the Geneva Convention of 1958 and the 1982 Convention on the Law of the Sea. For an enclosed body of water to be considered part of the open sea, it must have a navigable salt water connection to the general body of salt water and this connection must be fully open to ships of all nations, regardless of whether this connection passes through the territory of one or more nations.⁹⁷ Here the Black Sea is clearly a case in point, its sole connection to the high seas being through the Bosphorous and Dardanelles straits, both salt-water bodies which, despite being under the sovereignty of one country, Turkey, enjoy open navigation to all except military shipping, as guaranteed by the Convention of Montreux of 1936. The Caspian Sea is also connected to the high seas via the Volga and Don rivers and the Volga-Don canal. That these rivers, and the canal linking them, are clearly not saline, severely undermines the case for arguing that the Caspian forms a normal part of international waters, as does the limitation of its accessibility to international shipping due to restrictions on shipping imposed by the Russian government which controls the Volga-Don river system.

The second issue, then, is what, if it is considered to be a lake or an inland sea, should be the mechanism for the division of its resources. Only in exceptional circumstances can the Russian view legally prevail and the Caspian be considered both as a lake and a lake to be governed by a special "condominium". Although for environmental reasons such a mutual regime would be desirable, common environmental policy does not preclude separate sovereign rights over mineral resources.⁹⁸ Indeed precedence shows this to be by far the most frequent solution in such cases, with sectors divided into exclusive zones based on the principle of median lines. Despite there being a good case for arguing that the Caspian is indeed a lake, detachment from international waters need not necessarily impede the Caspian being regarded as a sea to be governed by the law of the sea and thus also similarly divided. Thus, according to international law and precedent, the Russian case appears to be the weaker, but Russia still possesses great economic and military influence and its

⁹⁷ Ibid., pp. 587.

⁹⁸ Thus the Caspian states have managed to agree on protecting the sea's sturgeon stocks, while the battle over oil rights still rages on, (*Interfax*, 7 February 1997).

objections to the present extraction deals provide useful ammunition with which to gain further leverage over its smaller southern neighbours.

In any case, the Russian government's policy on this issue has been marked by inconsistency: its apparent acceptance of Kazakhstan's appropriation of its portion of the Caspian for exclusive exploration by the Kazakhstancaspiisheif consortium of companies runs counter to its usual assertions concerning the sea's status.⁹⁹ Likewise, on closer examination, Russian policy on this dispute seems to have been determined more by the exigencies of events and by the varying interests of different ministries than by a point of principle. Russian opposition to the joint exploration and extraction of Caspian energy reserves by Kazakhstan, but particularly by Azerbaijan and Western oil companies, was clear from the beginning. However, objections intensified as such deals were reaching fruition, then diminished until the next round of negotiations. Thus in February 1994, as Haydar Aliyev was visiting heads of state in Turkey, France and Britain to discuss the implementation of the first such large oil deal (the agreement over the ACG oilfields with the AIOC consortium led by BP), the Russian foreign ministry delivered a letter to the British embassy in Moscow.

This letter warned that any possible agreement over the joint extraction of Caspian energy reserves between Azerbaijan and Western consortia could be invalidated due to the uncertain status of the Caspian Sea; it stated that the Caspian is:

*an object of joint use, within whose boundaries all issues of activities, including resource development, have to be resolved with the participation of all the Caspian countries ... any steps by whatever Caspian state, aimed at acquiring any kind of advantage with regard to the areas and resources of the Caspian Sea, run counter to the interests of the other Caspian states and cannot be recognised.*¹⁰⁰

Such objections became especially intense immediately after the deal was signed on 20 September 1994 (it will also be remembered that there was a coup attempt at this time which many put down to Russian involvement). Andrei Kozyrev, the Russian foreign minister, repeated the Russian stance on the status of the Caspian, pointing to agreements signed during the Soviet era limiting exploitation, saying "no one has annulled them. The former Soviet

⁹⁹ G. Englefield, *op. cit.*, pp. 31.

¹⁰⁰ Quoted in the *Financial Times*, 22 June 1994.

republics are the Soviet Union's legal heirs, while Russia is its main successor."¹⁰¹ Meanwhile contrary messages were emerging from the Russian energy ministry; Russian energy ministers were present during the signing of the 20 September accord which included a 10 per cent share by the partly state-owned Russian oil company Lukoil. Speaking for Lukoil, Alexander Vasilenko said:

*we signed a statement of intent with the state oil company of Azerbaijan last September. There was an inter-government agreement between Russia and Azerbaijan signed last October, which Yuri Shafranik (the Russian energy minister) signed permitting an agreement between Lukoil and Azerbaijan, Lukoil always works within the bounds of the law, and that is how we intend to work now.*¹⁰²

Acknowledging the differences between the interests involved, the energy ministry stated that these also extended to the various ministries "each of which could have its own position." So while the foreign ministry ominously warned that Russia, in order to assert its view, it would "undertake measures which will, in its opinion, be necessary,"¹⁰³ against the other Caspian states, Shafranik at the energy ministry, declared that he considered "talk about the status of the Caspian unfounded."¹⁰⁴

Similarly, Iranian criticisms of the proposed Azeri regime for the development of Caspian resources came hard on the heels of their exclusion from the AIOC consortium. Having been awarded a 5 per cent share of AIOC in November 1994,¹⁰⁵ Iran was subsequently excluded from participation in the consortium, under pressure from the US government in early 1995.¹⁰⁶ The Iranian foreign minister, Ali Akbar Velayati, was then reported to have declared that he no

¹⁰¹ Quoted in *Ibid.*, 23 September 1994.

¹⁰² *Ibid.*

¹⁰³ *Ibid.*, 3 March 1995.

¹⁰⁴ Quoted in *Business Mooskoskie Novosti*, 21 June 1995, *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 6-7, 1995, pp. 5.

¹⁰⁵ *The Financial Times*, 14 November 1994.

¹⁰⁶ *Ibid.*, 8 May 1995. The US Embassy in Baku published a letter threatening the withdrawal of American firms if Iran received a share in AJOC, (*Segodnia*, 31 January 1995; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 1, 1995, pp. 23).

longer recognised the legality of the consortium until all issues regarding the status of the Caspian Sea were resolved.¹⁰⁷ After the distribution of the old Soviet Caspian fleet in April 1992, Iran is also reported to consider invalid the clause in the 1828 Treaty of Turkmenchai forbidding its own military presence on the Sea.¹⁰⁸ While Abbas Maliki, Iran's deputy foreign minister, added that "until there is a new legal regime, the old regime is in effect ... all the countries must compromise regarding a new regime."¹⁰⁹

However, there have also been conflicting messages emerging from Iran on the question of the Caspian Sea, with the oil minister, Guliam Reza Agazadeh, declaring, "Iran will be guided by economic expedience and not political conjuncture in solving problems about utilising Caspian oil and gas fields."¹¹⁰ Besides this, the Iranian government also took the initiative of creating the Caspian Sea Organisation (CSO) which aimed to be a mechanism for solving the common issues of Caspian littoral states.¹¹¹ Despite some apparent success in beginning to address ecological questions (as part of a project sponsored by the UN) such as pollution and the rising water level,¹¹² agreement over the fundamental issue - rights' utilisation of the sea's mineral reserves - has remained impossible to achieve and the CSO has been left largely defunct.

Complicating the issue has been the position taken up by the government of Turkmenistan. In late January 1997, Turkmen officials laid claim to part of the oilfields being developed by the AIOC consortium. They said that the Azeri field and part of the Chirag field belonged to Turkmenistan.¹¹³ This disagreement seems to have been over the demarcation of the boundary between Turkmenistan and Azerbaijan rather than arising from a different view of the Sea's status. Thus the Turkmen claim was rejected by Russia whose view

¹⁰⁷ *Kommersant-Daily*, 12 May 1995, *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 4-5, 1995, pp. 9.

¹⁰⁸ M.E. Ahrari, "The Dynamics of the New Great Game in Central Asia," *Central Asian Survey*, vol. 13, no. 4, 1995, pp. 535.

¹⁰⁹ Quoted in the *Financial Times*, 17 May 1995.

¹¹⁰ Quoted in *Nezavisimaia Gazeta*, 20 December 1995, *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 12, 1995, pp. 17.

¹¹¹ E. Hoogland, "Iran and Central Asia," in A. Ehteshami (ed.), *op. cit.*, pp. 119.

¹¹² *Zerkalo*, Baku, 22 April 1995, *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 4-5, 1995, pp. 9.

¹¹³ *Reuters*, 30 January 1997.

was that the fields were no more the property of Turkmenistan than they were of Azerbaijan.¹¹⁴ Turkmenistan has both agreed with Russia and Iran on the joint development of the Caspian's resources and also with Kazakhstan and Azerbaijan recognising separate development rights over the sea.¹¹⁵ Turkmenistan is very vulnerable to Russian pressure - its impoverished economy was brought to a virtual halt after Russia stopped Turkmen gas flowing to Western Europe¹¹⁶ - the Turkmens are obliged not to step too far from the Russian line on the question of the Caspian's status.

On the other hand, the position of Azerbaijan and Kazakhstan was set out in no uncertain terms by Vyacheslav Gizzatov, the Kazakh deputy foreign minister: "The Caspian Sea should be recognised as a sea, territorial waters determined and put under the provisions of the International Law of the Sea."¹¹⁷ While, according to Natic Aliyev, president of SOCAR, Russia's failure to distribute profits from Caspian oil to Iran during the Soviet era, and Iran's failure to claim them, severely damages their present claim that the Caspian's mineral resources must now be shared.¹¹⁸

Support has also been gained, as predicted, from the Western governments whose oil companies are closely involved in the extraction of Azeri oil. The most important of these allies has been the US. Glen Rase, director of international energy policy at the US State Department, proclaimed that the Russian view, "cannot be imposed on those states that prefer a more normal division of the Caspian," that "each of the countries in the region has the right to develop its own economic resources according to its own best interests," and added a vague threat: "there should be no misunderstanding of this point, the United States will defend our companies' interests in the Caspian."¹¹⁹

In response to such veiled threats, even the hard-line faction within the Russian government has shown signs of pragmatism. Indeed, alongside the same protestations over the illegitimacy of the Caspian oil contracts, there have

¹¹⁴ *Interfax*, 21 February 1997.

¹¹⁵ *Europe Energy*, 20 November 1996; *Reuters*, 27 February 1997.

¹¹⁶ *Reuters*, 30 January 1997.

¹¹⁷ Quoted in the *Financial Times*, 3 March 1995.

¹¹⁸ N. Aliyev, "State Oil Company of Azerbaijan Republic: Current Developments," *Azerbaijan International*, vol. 2, no. 4, Autumn 1994.

¹¹⁹ Quoted in the *Financial Times*, 3 March 1995.

always been allusions that such disputes could easily be solved, if an agreement favourable to Russia were reached over the issue of oil transportation routes. Retracting his earlier position on the status of the Caspian, Russian energy minister Yuri Shafranik stated in November 1994 what has been Russian policy on this issue ever since, namely that Russia is "obliged" to take part in all energy projects undertaken in the Caspian basin. Using the model of one of the largest gas fields in Kazakhstan where the Russian Gazprom monopoly holds a 15 per cent share (and for which it has omitted to pay),¹²⁰ Shafranik rather unsubtly suggested a solution to the question of the Caspian Sea's status:

*The example of the Karachaganak field shows that we come back to this point; we have to work jointly in this kind of project ... it's all connected to the issues of pipelines and the use of energy.*¹²¹

The involvement of the Russian company Lukoil in Caspian Sea projects is thus seen as the price of gaining at least tacit Russian permission for continued exploitation of the sea's mineral stocks. AIOC president Terry Adams suggests that "the participation of companies from a variety of nations should facilitate our relations with their respective governments."¹²² According to Susan Whitbread, director of management consulting at MAI Consultants which has worked on this issue, "the substantial presence of Lukoil in Azerbaijan is regarded as silent approval of the signed agreements by the Russian government. As a result, such problems as the Caspian Sea's status - although they remain on the agenda - have lost some of their acuteness."¹²³

Indeed this particular problem is likely to remain on the agenda. Russia seems unlikely to win the legal argument over the Caspian and, after the debacle of Chechnya, is probably unwilling and unable to attempt to impose its view. Moreover, while Azerbaijan is willing to award shares in the major oil contracts to Russia and, to a lesser extent, to Iran, these countries are also unlikely to let the issue drop since this would mean a lessening of their leverage and possibly an end to their participation in future projects. This participation is due largely to their political clout rather than to purely

¹²⁰ Ibid., 29 April 1996.

¹²¹ Quoted in Ibid., 9 November 1994.

¹²² Quoted in Russian Petroleum Investor, June/July 1996, pp. 47.

¹²³ Ibid.

commercial considerations. The present status quo is therefore likely to continue.

The Pipeline Issue

The other major issue which similarly involves the overlap of commercial, political, geopolitical and practical decision-making has been the question of the transportation of the oil to world markets. Azerbaijan's landlocked location means that it must rely on neighbouring states in order to convey not just its oil but also all its goods to these markets. By the same count, Azerbaijan is thus largely reliant upon these same states for the importation of goods from the outside world. The ability of regional states to inhibit the passage of goods through Azerbaijan's borders, but most importantly, to block the flow of oil to markets, constitutes a major source of leverage for those states and a major potential impediment to the achievement of economic development and independence for Azerbaijan. By the same count, the enormous potential earnings to be gained in the form of transit rents on Azeri oil by regional states enables Azerbaijan to exert a certain counter-influence by its choice of transit route. The problem for Azerbaijan is that there are few such routes available and that none of the available routes is free from potential pitfalls.

As the existing mechanisms for exporting Azeri oil, either through the existing Soviet era pipeline network, or by rail-tanker, are inadequate for expected future flows, the most efficient method of transportation would be through new pipelines. The closest exits to the open sea are by the Black Sea, the Mediterranean Sea and the Persian Gulf, and these, in the most basic terms, are the three alternative export routes. The pipeline solution for Azerbaijan, however, is also tied to a regional solution for oil exports, especially those of Kazakhstan. Finding a solution to this problem has involved beating a path through the minefield of complexities of Azerbaijan's tangled international relations, and it is a question which remains to be fully answered, though a partial temporary settlement, but not a solution, has been found.

In purely practical terms, by far the easiest solution would be to link up to the existing Iranian pipeline network which connects with the Gulf and extends as far as Tabriz in Iranian Azerbaijan. At present this route is unacceptable due to the large American involvement in the major Azeri oil projects and the US government's certain veto of any such deal. Although often dismissed out of hand, this route has the advantage of proximity to the Far Eastern markets which are predicted to be so important in the next century, and while for the

moment the US veto on this route is in force, neither it, nor the conditions which have led to its imposition (the nature of the Iranian regime) need continue indefinitely; a change in either condition could quickly lead to the Iranian route as the preferred choice for the export of Caspian energy resources.

The route to the Mediterranean has long been a favoured option amongst certain sectors of Azeri opinion. Under the strongly pro-Turkish premier Elchibey an agreement was signed with Turkey in March 1993 to build a pipeline from Baku to the Turkish Mediterranean port of Ceyhan.¹²⁴ The pipeline would have entered Turkey via the enclave of Nakhichevan after following the line of the Iranian border from Baku, made a brief excursion into Iranian territory to avoid Armenia and been over 1,000 kilometres long.¹²⁵ The major difficulty with this route is that it must pass through Turkish territory which, since 1984, has been subject to widespread violence by the Kurdish separatist movement, the PKK. Turkish ministers point out, however, that pipelines from Turkey's own oilfields around Batman and the dual pipeline from Iraq's Kirkuk fields have operated in the same area with little difficulty.¹²⁶ This particular option was, in any case, soon invalidated after Armenian forces overran the Iranian border areas in the weeks following the agreement. The subsequent fall of Elchibey and rise to power of Haydar Aliyev were seen in Turkey as a major blow to their Azerbaijan policy.¹²⁷ But Aliyev's overtures to Russia and seeming disregard for Turkish aspirations had more to do with economic and political realities than with a sea-change in foreign policy. Aliyev explained,

In 1993 when I came to office as President, they brought me a letter; a treaty ... Before any oil production had begun, before any petroleum contract had been signed, they'd prepared a treaty. Underneath it had fifteen signatures. The leaders had signed it too. It said, 'The pipeline will pass through Turkey' ... I'm sorry, but if there is no agreement about oil extraction and no production, to announce where the pipeline

¹²⁴ The *Financial Times*, 10 March 1993; M.J. Sagers, *op. cit.*, pp. 351.

¹²⁵ G. Englefield, "Oil and gas pipelines in Central Asia," *IBRU Boundary and Security Bulletin*, January 1994, pp. 55.

¹²⁶ *Cumhuriyet*, 24 October 1995.

¹²⁷ Elchibey's demise was greeted with headlines such as "the end of Elchibey is the end of the Turkish model" or 'Elçibey'in sonu, Türkiye modelinin sonudur', (*Cumhuriyet*, Istanbul. 24 June 1994). See also *Briefing*, 14 February 1994.

*is going to go is pointless. This was a piece of paper with neither legal nor economic foundation.*¹²⁸

At the same time, pressure was being applied over the status of the Caspian Sea; a blockade was imposed by Russia on its borders with Azerbaijan¹²⁹ and Russia seemed to be linking this question to a solution in its favour over pipeline routes - that is, one which would pass through Russia and not Turkey. Vagit Alekperov, president of the Russian oil company, Lukoil (but, interestingly, born in Baku), insisted that a pipeline to the northern Black Sea port of Novorossiysk was the most economic and secure.¹³⁰

The "northern route", as it is known, has a number of advantages as an export solution for Azeri oil. First is that it would utilise an existing pipeline built during the Soviet era; second is consequent lower cost. The drawbacks are that the pipeline is badly deteriorated and not functional in places.¹³¹ What is more, the pipeline was built to carry oil to refineries around Baku from fields further north, so the pipeline and pumping stations along the way would have to be refurbished to "reverse the flow", an operation said to cost US\$16-18 million.¹³²

More important than the extra expense that such complications entail is the passage of the pipeline through Grozny, capital city of the troubled Russian Federation Republic of Chechnya. Chechnya unilaterally declared independence in 1991, but faced invasion by Russian forces seeking to halt the

¹²⁸ Taken from a speech at a conference on Turkish and Azeri economic co-operation, 30 May 1996, quoted in *Cumhuriyet*, 14 July 1996.

¹²⁹ The official reason given for this blockade was to prevent infiltration of Azeri forces into Chechnya, though most observers interpreted it as a move to "punish." Azerbaijan for the successful conclusion of the oil deal and its proposed routing through Iran and Turkey and not through Russia. See: *Moskovskie Novosti*, 15-22 and 22-29 January 1995; *Literaturnaia Gazeta*, 18 January 1995, *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 1, 1995, pp. 23-25.

¹³⁰ *Kommersant-Daily*, 2 February 1995, *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 2-3, 1995, pp. 15.

¹³¹ Dorian, Rosi & Indiriyanto, "Energy Developments in the Former Soviet Union," *Post Soviet Geography*, vol. 35, pp. 422.

¹³² *The Financial Times*, 20 July 1995.

breakaway in early December 1994.¹³³ Many have argued that the timing of the military action by Russian Federation forces in Chechnya was not unconnected with the "contract of the century", signed in Baku two and a half months earlier.¹³⁴ During the Russian intervention in Chechnya there were constant threats from the Chechen side to the effect that, "without Chechnya's consent, the pipeline will not operate."¹³⁵

Well might these threats be taken seriously. There have been numerous attacks on oil and gas pipelines by the rebels in Chechnya and neighbouring Dagestan and the Lenin oil refinery in Grozny has also been set ablaze.¹³⁶ Against this, Russian officials point out: "if the Chechen fighters want to attack a pipeline, they can attack one outside Chechnya as easily as one inside Chechnya" and "the Chechens understand that the pipeline is their chicken which lays golden eggs; no one butchers such a chicken."¹³⁷ While this may be true, pilfering the eggs remains another option; during the period between late 1991 and late 1994, it is estimated that up to 15 million tonnes of oil "went astray" in the Chechen pipeline system.¹³⁸ This process is indeed ongoing, with numerous illegal valves and taps being made into the pipeline throughout Chechnya, leading to small refineries making low quality petrol.¹³⁹ In August 1996, Nikolai Koshman, the then prime minister of Chechnya's Moscow-installed government, stated in a press conference that the pipeline had been disabled due to such activities and that an incredible "one hundred and forty-nine secret mini-refineries have been found in the past two weeks alone."¹⁴⁰

¹³³ Ibid., 12 December 1994.

¹³⁴ See for example: *Kommersant-Daily*, 10 January 1995; *Nezavisimaia Gazeta*, 20 January 1995 and *Izvestia*, 21 January 1995; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 1, 1995, pp. 20-21 for the Russian press; *Cumhuriyet*, 11 January 1995; *Yeni Yüzyil*, 15 January 1995 for the Turkish press and *The Times*, 7 January 1995 and the *Financial Times*, 20 July 1995 for the British press.

¹³⁵ *Kommersant-Daily*, 19 January 1996; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 1-2, 1996, pp. 7.

¹³⁶ *The Washington Post*, 23 February 1996; *Jamestown Monitor*, 13 March 1996; *New Europe*, 17-23 March 1996.

¹³⁷ *The Financial Times*, 5 September 1995.

¹³⁸ Ibid., 20 July 1995.

¹³⁹ *Baltic Business Weekly*, 29 July - 4 August 1996.

¹⁴⁰ Interfax News Report, reprinted in *New Europe*, 1 September 1996.

Asian Maskhadov's victory in the Chechen presidential elections on 26 January 1997 may offer the chance of stability in the troubled republic, vital to the movement of oil through its territory. Maskhadov has said that oil would move safely through Chechnya, though at a price. "We will ensure the safety of the oil pipelines, for a certain percentage. We think we should make a profit from any transportation of oil or gas, Maskhadov said.¹⁴¹ The matter of Chechnya's share in the route's transit fees, however, will be decided between the Chechens and the Russians. "Under our agreement with the Russian Federation, we turn over custody of the oil at the border and they give it back to us at Novorossiisk ... in the light of day, it's in their interest to see this work," said AIOC spokesman Greg Rich.¹⁴²

Once the oil has reached Novorossiysk, however, it must be transported by ship in order to reach its presumed Western markets. Here arises the second major difficulty with the northern route: the question of the navigation of the Bosphorous and Dardanelles straits, linking the Black Sea to the Mediterranean. Particularly hazardous is the Bosphorous strait passing through the city of Istanbul, which, though nineteen miles long, is only half a mile wide in places and subject to widely variable currents. Increased traffic, particularly of oil tankers, could pose a threat to the 12 million or so inhabitants of Istanbul, as well as provoke extreme ecological concerns in the event of a possible accident.

Passage through the Bosphorous and Dardanelles straits is governed by the Convention of Montreux of 1936. The Convention allows for complete freedom of transit and navigation for merchant vessels of all nations in time of peace and war (unless the war is with Turkey).¹⁴³ Vessels are not even obliged to request the assistance of tugs or pilots if they do not wish to do so. The predicament was amply illustrated on 13 March 1994 when an oil tanker collided with a cargo ship in the Bosphorous to the north of Istanbul with the loss of nineteen lives.¹⁴⁴ This accident coincided with negotiations over the

¹⁴¹ *Reuters*, 31 January 1997; *Economist Intelligence Unit*, 31 January 1997. *Globe and A Fail*, Toronto, 12 February 1997.

¹⁴² *Reuters*, 25 February 1997.

¹⁴³ For a fuller explanation of the terms of the Convention of Montreux, see H. Lauterpacht (ed.), *op. cit.*, pp. 641-43.

¹⁴⁴ *Briefing*, 21 March 1994, pp. 4-5; the *Financial Times*, 15 March 1994.

route of Caspian pipelines and was immediately used by the Turkish government to back its case for a route to Ceyhan, bypassing the Turkish straits. Some regulation of traffic was then instituted by Turkish authorities covering the entry of large vessels and those of limited manoeuvrability, subject to currents, visibility, traffic density and the like.¹⁴⁵

The Russian government responded with protests that the new regulations were contrary to the terms of the Montreux Convention and international law, and began negotiations with its "historic partner", Greece, for another pipeline from the Bulgarian town of Burgas to Alexandropolis in northern Greece, bypassing the Turkish straits and Turkey altogether.¹⁴⁶ Despite the protestations of Russia and other neighbouring countries whose craft frequently use the straits, the new regulations remain in force.

Although the collision of March 1994 suited Turkey's pipeline politics, moves to revise the regulation of traffic in the straits and calls for a rescheduling of the Montreux Convention pre-date this event. There is also a good objective case for re-negotiating the convention. Traffic has increased from about 4,500 ships a year with a net tonnage of 7.5 million in 1938, to 24,100 ships and 105.5 million in 1985.¹⁴⁷ Meanwhile, the number of accidents has been rising from three collisions and three groundings in 1982, to 14 collisions, two grounding and two outbreaks of fire in 1994.¹⁴⁸

Once the Turkish plans no longer included Iran as part of the pipeline route, but instead proposed to convey the oil either through Armenia or Georgia and thence onto Ceyhan and the Mediterranean, the US government also weighed in with its support for the Turkish thesis. The Americans believed that by channelling the pipeline through Armenia, the large sums of money involved might be enough to persuade the two sides in the conflict of the value of peace in Nagorno-Karabagh.¹⁴⁹ With no sign of any desire for peace there, Azeri and

¹⁴⁵ *Briefing*, 16-23 May, pp. 12.

¹⁴⁶ *Ibid.*; *Segodnia*, 21 April 1995; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 4-5, 1995, pp. 27; *Kommersant-Daily*, 17 June 1995; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 6-7, pp. 2-3.

¹⁴⁷ *Cumhuriyet*, 8 July 1996.

¹⁴⁸ *Ibid.*, 9 July 1996. Major accidents in the Turkish straits since 1979 have resulted in the deaths of over 65 people and 20,000 sheep, (sinking of the *Rabunion-18*, 11 November 1991).

¹⁴⁹ *Briefing*, 6 February 1995; the *Financial Times*, 19 April 1995.

Turkish opposition to this proposal effectively left the route through Georgia as the only alternative to Novorossiysk. With such delicate negotiations on the agenda there was a further *coup* attempt against Haydar Aliyev in March 1995,¹⁵⁰ but on this occasion several Turkish citizens were implicated in the plot. Aliyev was further enraged when the Turkish prime minister, Tansu Çiller, used an increase in TPAO's shares in AIOC to make political headway in Turkey and presumed that this meant the Turkish case for building the pipeline to Ceyhan was already won. Aliyev, in a show of strength, then reportedly telephoned Süleyman Demirel, the Turkish president, threatening to cancel the share increase unless Çiller travelled to Baku to sign the deal personally, which she was then forced to do.¹⁵¹

The inconsistency and instability of Turkish policy did nothing to help its cause. Between 1992 and 1995, Turkey changed its foreign minister no fewer than seven times. As Ceyhan then became increasingly unlikely to be chosen as the destination for early oil, Turkish interests began to give support to an alternative route through Georgia, believing that this would eventually inevitably lead to its extension to Ceyhan as "main oil" came on stream.

A report by the US company Brown & Root in April 1995, however, pointed out that if instead of the Georgian Black Sea port of Batumi (which is already connected to the pipeline network), the pipeline were routed to Supsa further up the coast, it would be possible to build a new oil terminal with a greater capacity. Despite warnings from BOTAS, the Turkish state pipeline company, that this greater capacity could invalidate the need for the route to be extended to Ceyhan,¹⁵² Turkish ministers then proceeded to support the latter route to Supsa and even offered to pay for its construction. What is more, when the minister responsible, Emre Gönensay, sent official confirmation of this offer to AIOC, having added the condition to the financing that the capacity at Supsa be kept to a minimum (to protect the Turkish straits), he then neglected to add the intended condition that the pipeline be later extended to Ceyhan.

¹⁵⁰ *The Financial Times*, 16 March 1995.

¹⁵¹ *Cumhuriyet*, 16 July 1996.

¹⁵² Both Ukraine and Romania are keen to receive oil from the Georgian route, for domestic consumption as well as for re-export to European markets, thus alleviating pressure on the Bosphorous and undermining the Turkish argument for Ceyhan, (*Reuters*, 11 April and 15 April 1997).

Apparently he forgot!¹⁵³ When this final condition was added, the Turkish offer was rejected.¹⁵⁴

Terry Adams, AIOC president, then announced that the choice had been narrowed down to either the Russian or the Georgian route for early oil. The route to Ceyhan was, for the time being at least, out of the running.¹⁵⁵ The Azeri government then came under increased pressure. The border with Russia was still closed, one million Azeri citizens were still refugees and the economy was facing crisis. Not selecting the Russian "northern route" could mean an intensification of Russian protests over the status of the Caspian Sea, whereas choosing this course could lead to de facto recognition of Azerbaijan's rights over its sector of the Sea. Then there was the conflict with Armenia; although a cease-fire had held for more than a year, Russia could easily rekindle passions if it so chose. To counter these compulsive arguments, Turkish prime minister Tansu Çiller threatened to summon the environmental protest group Greenpeace to the Bosphorous and cautioned, "not a drop of oil will pass through the Bosphorous," if the Georgian route were not chosen. But, somewhat illogically, if the Georgian route, or both routes, were chosen, then this same oil would be allowed to pass.¹⁵⁶ The Russian state oil pipeline company Transneft, furthermore, offered to undercut the Georgian tariffs by at least 20 per cent and the Russian government signed a protocol guaranteeing to substitute Russian crude for any Azeri oil "lost" in transit.¹⁵⁷

Such irresistible persuasion from Russia and the inconsistency and illogical threats coming from Turkey, added to the lower cost of the "northern route" (US\$50 million compared with US\$275 million for the "western" Georgian route), made the decision of the Azeri government and AIOC much easier. Since the western route would take longer to construct anyway, a decision on it could even be left to a later date. With this in mind, AIOC reportedly prepared to announce its choice of a single pipeline to the north. Only last minute

¹⁵³ For a fuller account of this political farce, see the series of articles by Lale Sariibrahimoglu, "Gizli Belgelerle, Boru Hatti Bozgunu", ("The Pipeline Failure, from Classified Documents"), *Cumhuriyet*, 14-20 July 1996.

¹⁵⁴ *Reuters*, 9 May 1995; *New Europe*, 21-27 April 1995; *Jamestown Monitor*, 10 May 1995.

¹⁵⁵ *The Financial Times*, 25 May 1995.

¹⁵⁶ *Ibid.*, 13 September 1995.

¹⁵⁷ *Ibid.*, 5 September 1995.

telephone calls between Tansu Çiller and US president, Bill Clinton, and Clinton's subsequent intervention with the Azeri president secured the selection of both the Russian and Georgian pipeline routes.¹⁵⁸ In a 25-minute telephone conversation with Haydar Aliyev, Clinton is said to have "expressed his support for commercial viability ... and multiple pipelines that would benefit the companies investing in oil development as well as the countries of the region."¹⁵⁹

The decision, announced in early October 1995, to utilise two pipeline routes, however, concerned only the export of "early oil". It is envisaged that new pipelines will be built to carry the "main oil", which should begin to flow early next century. The decision on the later pipeline(s) will depend on the experience of operating the first and on geopolitical developments in the region. According to John Browne, managing director of BP exploration, if difficulties occur, risks can be minimised by "pacing investment according to the means of getting the oil out."¹⁶⁰ Similarly, AIOC president Terry Adams maintains that "both pace and timing (of investment) will emerge as regional export solutions fall into place."¹⁶¹

So while this decision on the "dual-pipeline" approach will have a great deal of bearing on the course of future export routes, it does not reflect any actual commitment to build pipelines for "main oil" along the same routes.

In many ways, the contest among regional players to gain pipelines over their territory is not yet complete. The same factors which influenced the earlier struggle will come into play in the conflict for routes for "main oil", only then these regional powers will also have to prove their goodwill by co-operating with the export of early oil. Following the announcement of the oil route decision, Terry Adams declared, "as we see it now, Ceyhan will be the eventual exit point for the main pipeline."¹⁶² It is thought that in the meantime the US government is working hard to bring about the passage of this pipeline through Armenia.

¹⁵⁸ *Cumhuriyet*, 17 July 1995.

¹⁵⁹ *The Financial Times*, 9 October 1995.

¹⁶⁰ Quoted in the *Financial Times*, 21 September 1994.

¹⁶¹ T.D. Adams, *op. cit.*, pp. 45.

¹⁶² Quoted in the *Financial Times*, 10 October 1995.

A network of pipelines extending throughout the region, it is hoped, would bring greater integration of national interests in the area and the lessening of ethnic tensions. Steve Remp, chairman of oil services company Ramco, expresses the common view of those involved in the oil industry in Azerbaijan, saying, "what you will see in due course is that the issue will turn from being a liability to being a very positive generator of income for the area."¹⁶³ Enhanced wealth could then lead to increased stability and an exit from the cycle of tension and violence into one of prosperity and development.

END OF

¹⁶³ Quoted in Ibid., 23 November 1994.

PART THREE

NEIGHBOURS

The presence of oil in Azerbaijan so far, however, has been a mixed blessing. As well as attracting the attention of the world's major oil companies, the energy reserves of the Caspian have attracted the sometimes unwelcome attention of outside powers, in particular the historic regional rivals: Iran, Turkey and Russia. The three Caucasian states of Armenia, Georgia and Azerbaijan share the geopolitical fate of being squeezed between these ex-imperial powers, but their relations also possess an internal dynamic entirely their own. In order for Azerbaijan's oil resources to be effectively exploited, internal stability is first of all a necessity, but because of its essentially landlocked status, Azerbaijan must also rely on the stability of its close neighbours. The development of the oil industry is thus affected by regional relations as well as being a factor in forming them.

In an ethnic patchwork such as the Caucasus, one of the major challenges to stability is that posed by inter-ethnic conflict and ethno-nationalist movements. Ethnic conflicts such as that in Nagorno-Karabagh, but also in Chechnya, Abkhazia and in south-eastern Turkey, have had grave destabilising consequences for the region and have handicapped Azerbaijan's attempt to develop economically through its energy reserves. Such conflagrations can draw in regional powers but may also be deliberately inflamed by them as foreign policy instruments. Although the root cause of these rivalries and ancient hatreds perhaps has little to do with the effect of oil, the impact and prospect of immense wealth could also easily lend such tensions an explosive edge.

The Caucasian Triangle: Azerbaijan, Armenia and Georgia

(1) Armenia

Of all the potentially damaging regional conflicts that in Nagorno-Karabagh involving Armenia is, for Azerbaijan, without doubt the worst. Armenia has traditionally been viewed as Russia's partner in the region and for historical reasons harbours deep grudges against Turkey and Turkic nations such as Azerbaijan. While the Armenian government scrupulously denies any

territorial ambitions over Nagorno-Karabagh, the fact that it is now controlled by Armenians and not Azeri Turks is regarded as perhaps their greatest national achievement.¹⁶⁴

Hostilities between ethnic Armenians and Azerbaijan over the Nagorno-Karabagh enclave left the Armenian forces, widely supported by Armenia proper, controlling the Karabagh and large swathes of Azeri territory outside the province. Entrenched opinion and political instability at home rendered concession on the issue impossible for both Haydar Aliyev and Armenian president Levon Ter Petrossian.

With stalemate on the battlefield, signs of moderation have crept into the stances of both leaders. Ter Petrossian moved to ban the extremist Armenian Revolutionary Federation or Dashnak party in January 1996, branding it a "terrorist and fascist organisation".¹⁶⁵ The Dashnaks, largely from the Armenian diaspora, had demanded the suspension of all ties with Turkey until that country recognised its responsibility for the massacres of Armenians in the early part of the century - something Turkish governments have refused to do for eighty years. The important Armenian lobby in the US from which the Dashnaks gain much support, was also behind Senator Bob Dole's "Humanitarian Aid Corridor Bill" which threatened to reduce aid to Turkey unless it allowed humanitarian assistance to Armenia to be shipped through its borders.¹⁶⁶ In contrast Terri Petrossian has been trying to mend relations with Ankara in order to gain relief from the effects of the double blockade from Turkey and Azerbaijan. Recent policy shifts by the Armenian government indicate a willingness to achieve a rapprochement with Turkey which some observers put down to eagerness to have the pipeline for main oil pass over its territory and US pressure to bring this about.¹⁶⁷

(2) Georgia

¹⁶⁴ *The Financial Times*, 7 June 1995.

¹⁶⁵ *Ibid.*

¹⁶⁶ *Briefing*, 20 February 1995.

¹⁶⁷ *Zavtra*, 17 April 1996; *Vek*, 29 April 1996; *Briefing*, 27 February 1995.

Of these adjoining states, Georgia has also experienced extensive interference from Russia in its internal affairs since independence, as well as a number of *coup* attempts, virtual civil war and separatist movements in the provinces of South Ossetia and Abkhazia. Blame for the successful breakaway of these regions has often been heaped on Moscow, and it is difficult to realise how the Abkhaz, who constitute less than 20 per cent of the population of their titular province,¹⁶⁸ might have otherwise succeeded in splitting from the rest of Georgia. With few natural resources of its own, Georgia's position as a vital conduit for goods between Turkey, the Russian Federation, Armenia and Azerbaijan has seen it maintain cordial relations with all of these. In turn, its capacity to transport oil from Azerbaijan to the Black Sea is seen as one of the country's major geostrategic advantages.¹⁶⁹ Shared experience and coincidence of interests have led to the formation of close relations with Azerbaijan. These ties were formally consolidated during a recent visit to Georgia by Haydar Aliyev, during which 14 separate agreements were signed covering trade and economic collaboration as well as a Treaty of Friendship, Co-operation and Strengthening Mutual Security.¹⁷⁰ This last agreement hinted at settlement of the dispute in Nagorno-Karabagh through a policy of rigorous respect for territorial integrity - that is, no deals with separatists. Speaking of relations between the Caucasian states, Aliyev hoped that this agreement might mark the beginnings of "a new form of alliance between the three republics, which are no longer drawn into the political games of 'third countries'".¹⁷¹

Also signed during the same visit was an agreement between the two states, their respective oil companies and AIOC concerning the transportation of early oil through Georgia. It was agreed that the pipeline costing about US\$ 275 million would be financed by AIOC with tariffs set at 43 (US) cents per barrel (26 cents of which would accrue to Azerbaijan and 17 cents to Georgia).¹⁷² This agreement, more than any other, has set the seal on Azeri-Georgian relations. Moreover, Haydar Aliyev, after the signing, went on to stress the

¹⁶⁸ According to the 1989 census, Abkhaz citizens made up 17.3 per cent of the population of the Abkhaz ASSR, (P.B. Henze, *op. cit.*, pp. 153).

¹⁶⁹ See *The Guardian*, 22 February 1997.

¹⁷⁰ *Svobodnaia Gruzia*, Tbilisi, 9 March 1996; *The Commonwealth of Independent States and the Middle East*, vol. 21, no. 3-4, 1996, pp. 37-8.

¹⁷¹ *Bakinskii Rabochii*, Baku, 14 March 1996; *The Commonwealth of Independent States and the Middle East*, vol. 21, no. 3-4, 1996, pp. 38.

¹⁷² *Ibid.*; *Jamestown Monitor*, 11 March 1996.

importance of the pipeline for relations between Azerbaijan, Georgia and Turkey - a further link in the already busy trade between the three.¹⁷³ The political importance of the oil route for Georgia is indeed a greater consideration than the financial aspect. The state oil concern, the Georgian International Oil Corporation (GIOC), estimates that earnings from the pipeline will amount to only US\$8 million a year; the low tariffs are to enable AIOC to recover the cost of its construction, while the Georgian government will have to wait eight and a half years before it can demand a revision of the fees.¹⁷⁴ For Georgii Chanturiia, president of GIOC, the main advantage of the project is that "Georgia will obtain a more important geopolitical role."¹⁷⁵

The Regional Powers: Iran, Turkey and Russia

Squeezed between the three ex-imperial powers of Iran, Turkey and Russia, Azerbaijan, Armenia and Georgia have a great deal in common. In contrast to its neighbours, however, Azerbaijan is also intimately linked with all three: linguistically with Turkey; religiously with Iran and historically with Russia. Each of these large neighbours then believes that it has a keen interest in Azerbaijan. They are Azerbaijan's three biggest trading partners.¹⁷⁶ An independent Azerbaijan must succeed in reconciling these concerns with its own best interests and seek to find a regional balance whereby the regional powers may reconcile their differences with each other.

(1) Iran

¹⁷³ *Bakinskii Rabochii*, Baku, *op. cit.* (1996); *The Commonwealth of Independent States and the Middle East*, vol. 21, no. 3-4, 1996, pp. 38.

¹⁷⁴ *New Europe*, 25-31 August 1996.

¹⁷⁵ *Kommersant-Daily*; *The Commonwealth of Independent States and the Middle East*, vol. 21, no. 3-4, 1996, pp. 39.

¹⁷⁶ *Zerkalo*, 28 October 1995; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 10-11, 1995.

The vast majority of Azeris (some 78 per cent), like Iranians, are adherents of the Shia branch of the Muslim faith.¹⁷⁷ Iran's relations with Azerbaijan are complicated by the presence of some 10 million ethnic Azeris who live in the neighbouring provinces of northern Iran. Although the inhabitants of what Azeris north of the border like to call "southern Azerbaijan" have long had a separate existence from those in the north (since 1828), the Iranian regime remains quite sensitive to this issue.

When protesters from Nakhichevan broke down the border with Iran, contacting Azeris on the other side in late 1989, they were met largely with bemusement by the local population.¹⁷⁸ Nevertheless, as the conflict in Nagorno-Karabagh intensified, Iranian leaders were alarmed at Turkish reactions to it which called for ethnic and linguistic solidarity between Turkey and Azerbaijan. Ayatollah Ali Khamenei preferred to see the shadow of America behind the conflict and warned that it would be "a big blunder to think that ethnic and national motives are behind this move."¹⁷⁹

Disturbed by developments north of the border, Iran has been instrumental in moves to bring about peace in Karabagh.¹⁸⁰ Despite this neutrality, however, there remains the deep suspicion in Azerbaijan that Iran has sided with Armenia in the dispute for fear of Azeri irredentism and reasons of geopolitical self-interest. With Armenia suffering a double blockade from both Turkey and Azerbaijan, its only access points were Georgia and Iran. As supplies through Georgia were also threatened by local conflicts, Iran began increasingly to supply Armenia's needs. A proposed gas pipeline from Iran is viewed by the Armenians as their best hope of escaping the worst of the blockade and Iran has become second only to Russia among Armenia's trading partners.¹⁸¹

¹⁷⁷ A. Ehteshami, "New Frontiers: Iran, the GCC and the CCARs," in A. Ehteshami (ed.), *op. cit.*, pp. 99.

¹⁷⁸ T. Swietochowski, *op. cit.*, (1995), pp. 209-10.

¹⁷⁹ Foreign Broadcast Information Service, Near East and South Asia, 90, January 1990, quoted in T. Swietochowski, *op. cit.*, (1995), pp. 208.

¹⁸⁰ A. Ehteshami, and E. Murphy, "The Non-Arab Middle East States and the Caucasian/Central Asian Republics: Iran & Israel," *International Relations*, vol. 20, no. 12, pp. 86-87.

¹⁸¹ The *Financial Times*, 7 June 1995.

Further doubts over Iran's intentions towards Azerbaijan have been aroused by the perceived informal alliance between Iran and Russia in the Caucasus and Central Asia. This is largely due to a coincidence of interests by the two countries, particularly over energy issues. Among these, as has been noted, has been the clash over the status of the Caspian Sea. In this respect Iran's objections were, like those of Russia, tools of policy rather than a principled stance, arising only after Iran had been excluded from AIOC because of US pressure in early 1995. The inclusion of the Iranian Oil Industries and Construction Company in the Shah Deniz project, signed on 4 June 1996, will have done much to reduce these objections. Significantly this project involves no American organisation, and although publicly US officials object to this Iranian involvement, privately they admit to understanding Azeri concerns to include Iran in future oil projects in order to give it a vested interest in Azerbaijan's future stability.

Iran's potential as a route for exporting Azeri oil can never be entirely ignored. Elchibey's government had planned to use Iran for this purpose in its original proposal for a pipeline to Ceyhan, and while American objections and Armenian battlefield success killed this particular plan, the Iranian route must always remain an option. Indeed swap arrangements with Iran are being planned with even US companies trying to find loopholes in their government's legislation to enable them to profit from this kind of deal.¹⁸² Iran's enhanced profile in the gas pipeline network stretching from Central Asia to Europe is likely to increase its chances of involvement in similar oil pipeline projects.

Iran's fears of a Turkic bloc developing along its northern frontiers has largely failed to materialise, as has any desire in "southern Azerbaijan" for unification with the north.¹⁸³ Since the fall of Elchibey, Aliyev's government has done much to quell such Iranian fears and engage Iran in Azerbaijan's development, particularly with regard to oil. Nevertheless, suspicions remain on both sides. Iran objected strongly to a 1992 peace plan for Nagorno-Karabagh which would have exchanged the Lachin corridor linking the breakaway province with Armenia for a reciprocal link between Nakhichevan and Azerbaijan proper. This plan would also have had the effect of awarding Turkey a direct land bridge to Azerbaijan and the rest of the Turkic world.¹⁸⁴ While Azerbaijan

¹⁸² Ibid., 10 May 1995.

¹⁸³ Apparently the joke amongst Tabrizis is; "why should we want to join another country when we already run the one we're living in now!".

¹⁸⁴ H.Y. Freij, "State Interests Versus the Umma: Iranian Policy in Central Asia," *Middle East Journal*, vol. 50, no. 1, Winter 1996.

remains ill at ease over Iran's perceived bias towards Armenia and its clear diplomatic co-operation with Russia.¹⁸⁵

(2) Turkey

Turkey, meanwhile, has close linguistic links with Azerbaijan. The language spoken by Turks and Azeris is quite easily mutually intelligible. Even before Azeri independence, Ankara was cementing ties with Baku, hosting visits from its leaders and showing moral support and indignation over the issue of Nagorno-Karabagh.¹⁸⁶ The Turkish press excitedly took up the issue and spoke of the "indestructible ties between Azerbaijan and Turkey based on common race, language and culture."¹⁸⁷ Exclusion from the European arena and loss of a diplomatic role due to the end of the cold war, gave the prospect of the rise of independent brother nations to the east an added importance in Turkish perceptions.

Nowhere was this enthusiasm more intense than in the case of Azerbaijan. Turkish policy was quickly assembled around the figure of the strongly pro-Turkish (and pan-Turkist) President Elchibey. The fall of Elchibey was seen as a body blow to Turkish interests in the region and the rise of the seemingly pro-Russian Aliyev viewed with misgivings.¹⁸⁸

These feelings were exacerbated as Aliyev took Azerbaijan back into the CIS, cast doubts over the pipeline to Ceyhan, proposed instead a route through Russia and then proceeded to award Iran a greater share in AIOC than the original 1.75 per cent held by the Turkish TPAO.¹⁸⁹

The reassertion of Russian influence in its "near abroad" and the realisation that Russia was still a very strong influence in the region, caused a reassessment of Turkish strategy in the Caucasus and a more measured approach. Added to this was the consideration that trade between Turkey and Russia amounted to over

¹⁸⁵ See *Ibid.*, pp. 72-77.

¹⁸⁶ A. Vassiliev, "Turkey and Iran in Caucasian Central Asia," in A. Ehteshami (ed.), *op. cit.*, pp. 139.

¹⁸⁷ Quoted in T. Swietochowski, *op. cit.*, (1995), pp. 208.

¹⁸⁸ See *Briefing*, 14 February 1994; S. Gümeç, "Tarihte ve Günümüzde, Azerbaycan," *Yeni Forum*, August 1993, pp. 30-42.

¹⁸⁹ *Briefing*, 21 November 1994.

US\$1,865 million in 1995, but that between Turkey and Azerbaijan was only US\$17 million for the same period. Turkey is Russia's biggest market in the developing world and Russia is Turkey's third biggest trading partner after the US and Germany.¹⁹⁰

Turkish ambitions in the region are also further weakened by Turkey's physical separation from Azerbaijan, except for the province of Nakhichevan,¹⁹¹ hence Turkey's enthusiastic backing of the US-sponsored peace plan linking Nakhichevan (thus Turkey) to the rest of Azerbaijan.¹⁹² To counter this physical isolation from Azerbaijan, Turkey has been assiduously cultivating its relationship with Georgia, offering to fund oil pipeline and rail links between the two countries;¹⁹³ Turkey now accounts for 32 per cent of Georgia's foreign trade.¹⁹⁴ Good infrastructure links between Turkey and Georgia are essential if Turkey is to benefit from oil projects in Azerbaijan. Common historical mistrust of Russia, but mainly mutual desire to gain from the transport of Azeri oil has helped cement this relationship.

Reference has already been made to the inconsistency of Turkish policy on Azerbaijan due to internal instability. Ankara's saving grace, however, has been the vital support of the US government. Having accepted the elimination of Ceyhan as an option for early oil, it was the last-minute intervention by the Clinton administration which averted total humiliating defeat for Ankara's pipeline policy. Together with this policy, US government officials have also paved the way for increased Russian acceptance of Turkish involvement in regional energy projects.¹⁹⁵ So far Turkey has gained little but goodwill from an independent Azerbaijan. This goodwill largely arises out of Turkey's support

¹⁹⁰ *Monthly Bulletin of Statistics of the Prime Ministry of Turkey*, January 1996; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 10-11, pp. 19.

¹⁹¹ Turkey was careful to ensure it gained a small corridor to Nakhichevan during Turko-Iranian border negotiations in 1932. See G.E. Fuller, *The Centre of the Universe*, (Boulder: Westview Press, 1991), pp. 199.

¹⁹² *Briefing*, 14 March 1994.

¹⁹³ *Svobodnaia Gruzia*, 5 April 1996; *The Commonwealth of Independent States and the Middle East*, vol. 21, no. 34, pp. 64.

¹⁹⁴ *Nezavisimaia Gazeta*, 3 December 1995; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 12, 1995, pp. 28.

¹⁹⁵ *The Financial Times*, 10 October 1995.

over the conflict in Nagorno-Karabagh and its resultant enforcing of an embargo on Armenia. Turkish authorities, however, have displayed willingness to sacrifice even this policy in the face of US pressure and the prospect of the big prize, the elusive pipeline to Ceyhan.¹⁹⁶

(3) Russia

Without doubt the greatest influence on Azerbaijan, however, is Russia. Although the Soviet Union is now disbanded, "an empire does not die easily, especially if it sits astride the geographical centre of the world's land mass and the relationship of forces evokes the image of a shark among sardines."¹⁹⁷ Russian interest in its former satellite states resembles that of other decolonising powers; Moscow wishes to maintain its strategic concerns and economic advantages without the previous economic burdens. Interference by outside powers in what was once its exclusive domain is also deeply resented. While present circumstances dictate that such intrusion must be tolerated, political regimes openly hostile to Moscow, seeking to escape Russian geostrategic hegemony or replace it with that of another power, have been faced with Russian measures aimed at causing instability. This is especially the case in republics rich in oil reserves.

While active Russian involvement in Nagorno-Karabagh is doubtful, Russian support for Armenia was vital. As one Azeri politician pointed out, "Russia could have stopped the war instantly had it chosen to stop supplies entering Armenia."¹⁹⁸ Conflicts in Abkhazia and South Ossetia have similarly been supported in order to destabilise Georgia. The dispute over the Caspian has also been utilised in this vein. Such weapons are particularly effective in gaining influence in newly independent states such as Azerbaijan. In recognition of this fact, Russia has gained shares in all the major oil production projects in Azerbaijan, as it is expected to do so in the future. Independence for Azerbaijan is not without its price.

The limit to Russian domination of the region has proved to be Chechnya. That the brutal war in the breakaway republic caused major damage to Russian designs to provide the eventual route for main oil is without doubt. Even the

¹⁹⁶ Ibid., 22 March 1996.

¹⁹⁷ T. Swietochowski, *op. cit.*, (1995), pp. 234.

¹⁹⁸ Interview with Zardusht Alizade, 29 July 1996.

passage of early oil may now be delayed.¹⁹⁹ The rise of nationalism, reappearance of communism and the ailments of President Yeltsin make the direction of Russian policy on this issue very fluid. What is now certain is that, given the experience of Chechnya, Russia is now unlikely to seek a military solution to its problems in the Caucasus. It too will have to look to diplomatic means to achieve its goals there.

There have been hot-headed statements in the Russian press claiming, "there is no doubt that (Turkey's) policy is directed at transforming the country in the shortest historical period into a regional superpower controlling the entire system of new politico-economic relations in Transcaucasia," and that Turkey harbours "neo-Pan-Turkic aspirations".²⁰⁰ But such outbursts are tempered by the close trading relationship enjoyed by the two countries mentioned above. Turkey is the most favoured destination for Russian tourists who spend an estimated US\$3-4 million a year there, while Turkish construction firms are engaged in contracts in Russia worth an estimated US\$4-5,000 million.²⁰¹ Both countries have come to realise that neither can exclusively dominate the Caucasus and that countries such as Azerbaijan have now, in any case an independent interest which is no longer so malleable to the designs of regional actors.

¹⁹⁹ *New Europe*, 18-24 August 1996.

²⁰⁰ *Nezavisimaia Gazeta*, 14 April 1995; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 4-5, pp. 5.

²⁰¹ *Kommersant-Daily*, 19 October 1995; *The Commonwealth of Independent States and the Middle East*, vol. 20, no. 10-11, pp. 19-20.

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CONCLUSION

The position of Azerbaijan astride such vast oil reserves has thus had a fundamental influence on its history and development. After becoming the world's first oil economy in the mid-nineteenth century, the decline of its oil industry under Soviet mismanagement meant the decline of Azerbaijan itself and its disappearance from the lexicon of international affairs. Ironically this very same mismanagement and technological deficiency of the USSR has meant that large oil reserves still remain to be exploited.

Azerbaijan's shaky start to independence was a product of the former maladministration, not only because of the economic underdevelopment, but also because of the ethnic discord which previous policies ensued. It is correct to say that Soviet boundary policy operated by "both recognising subordinate nationalities and ethnic groups, and dividing state lines that intentionally cut across ethnic and national residential patterns."²⁰² It is this policy which has left Azerbaijan with its most dangerous legacy: the conflict in Nagorno-Karabagh. This conflict, which is so central to the formation of the independent republic and its subsequent history, is also central to Azerbaijan's reasons for needing to develop its oil industry and, moreover, to the urgency with which it must achieve this end. Azeri oil is not just a tool for enrichment but a means of overcoming conflict and finding willing partners with which to form alliances; it is thus a means of achieving independence.

Azerbaijan's geographical position, however, precludes an easy progress to full oil production. The sudden and unexpected break-up of the Soviet Union has meant an entire absence of mechanisms for dealing with important issues such as the division and management of resources. Such deficiencies can easily be taken advantage of by parties who, for their own reasons, oppose the emergence of independent competitor states. The lack of consensus over the status of the Caspian Sea is a case of this nature and is an example of international law being used to serve national ends, or litigatory diplomacy perhaps. On a close examination of the legal arguments it emerges that the case for arguing for an equal division of the Caspian's resources is a thin one. Its

²⁰² C. Calhoun, "Nationalism and Ethnicity," *Annual Review of Sociology*, vol. 19, no. 211, 1993, pp. 39.

real significance is that it is put forward by such a powerful neighbour as Russia. Since in the past the supreme arbiter on such matters in this region has been Russia's military might, smaller adversaries such as Azerbaijan or Kazakhstan have good reason to fear an adverse judgement. It appears, however, that such an outcome is unlikely.

Russia's present leaders at least are unwilling, and for the moment unable, to enforce their view. Although the days of empire are over, Russia is still a powerful force in the region and due cognizance must be given of this. More than anything, the choice of routes for Azerbaijan's future oil exports will establish the future direction of its own relations but also profoundly affect the shape of future regional alliances.

The decision on future pipeline routes, for now, instead reflects the present alignment of forces. The passage of a major energy pipeline through a neighbouring country will entail a large part of those countries' future relations, forming an inter-reliance which can be mutually beneficial but which gives each an important weapon against the other: the ability to turn the taps off.

As a landlocked producer state Azerbaijan must look to its neighbours to help in the export of its energy resources. The problem for Azerbaijan is that all these routes must pass through the territory of ex-imperial powers which have all at one time controlled its territory; what is more they can be extremely jealous of each other. In this situation it does not do to be over reliant on any one of these countries for the export of such a vital resource. The contest which led to the selection of routes for early oil illustrates some of the forces involved in such a decision.

This struggle is likely to be repeated when the question of main oil comes up over the next few years. Already, however, even before early oil has begun to flow, there has been a re-alignment of forces in the region. The selection of the dual-pipeline option has meant that both Turkey and Russia have an interest in supporting the stability and peaceful development of an independent Azerbaijan. Initial signs of this are already emerging, as demonstrated earlier this year when authorities in Moscow arrested and offered to extradite former *coup* leaders Ayaz Mutalibov and Rahim Gaziyeu (see Part One), while at the same time Ankara vied with them, offering peacekeeping forces for Nagorno-Karabagh and further help in training Azeri military personnel.²⁰³

²⁰³ The *Financial Times*, 17 April 1996.

Neither is monopolistic control of pipeline routes beneficial to any party. Both Russia and Turkey are victims of fierce secessionist campaigns which could easily upset oil exports through their territories. Particularly for Moscow, sole control of export routes from Azerbaijan, if they continue to pass through Chechnya, would increase the viability of Chechen calls for independence and may therefore be likely to increase their intensity, whereas on the other hand, just as the fighting in Chechnya was spurred by attempts to control the pipeline, the downgrading of its importance by the existence of a secondary pipeline might lead to the lessening of hostilities.

This also applies to other conflicts in the region where Russia is increasingly backing peace efforts, for example in the breakaway Georgian provinces of Abkhazia and South Ossetia,²⁰⁴ but also in Nagorno-Karabagh.²⁰⁵

Potential sticking-points in this diplomacy include nations left without a means of profiting from Azeri oil and therefore no stake its stability. The most obvious of these countries are Armenia and perhaps partially Iran. In Armenia's case especial influence in the US can have a powerful effect on US regional policy.²⁰⁶ With very few assets aside from this and the possession of Nagorno-Karabagh, Armenia cannot be expected to trade the latter cheaply. It will be very tempting for US policymakers to link peace with the construction of a pipeline from Azerbaijan to Turkey through Armenia, thus linking the fates of three US allies in the area in the hope that prosperity might ease some of the discord between them. In the case of Iran, the US policy of advocating its complete exclusion from all oil deals in the Caspian may prove to be a dangerous exception. The inclusion of Iran in the Shah Deniz project may go some way to rectifying the imbalance between Iran's regional importance and its lack of involvement in Azerbaijani oil industry.

In the case of Azerbaijan then, achieving independence has been a case of ensuring interdependence among regional states. Despite major difficulties such as ethnic strife and the self-interest of local powers, much progress has been made towards this goal. Much of this progress is largely due to oil. By giving these states an interest and stake in the various projects of the oil industry in Azerbaijan, the Azeri government has given them a stake, too, in Azerbaijan's future.

²⁰⁴ Ibid., 22 March 1996.

²⁰⁵ Ibid., 6 March 1996.

²⁰⁶ See *Washington Post*, 2 May 1996.

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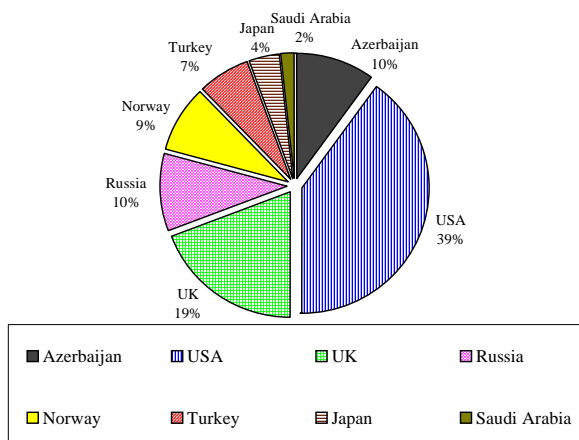
APPENDIX 1

Table 1.1: AIOC Participating Interests, July 1996*

Company Name	Percentage Interest	Country of Origin	Percentage Interest
SOCAR	10.0000	Azerbaijan	10.0000
Amoco	17.1000	USA	39.8770
Pennzoil	4.8175		
Unocal	10.0489		
Exxon	8.0006		
BP	17.1267	UK	19.2092
Ramco	2.0825		
Lukoil	10.0000	Russia	10.0000
Statoil	8.5633	Norway	8.5633
TPAO	6.7500	Turkey	6.7500
Itochu	3.9205	Japan	3.9205
Delta	1.6800	Saudi Arabia	1.6800

* Source: Agip

Figure 1.1: AIOC Participating Interests by Country, July 1996*



*Source: Agip

APPENDIX 2

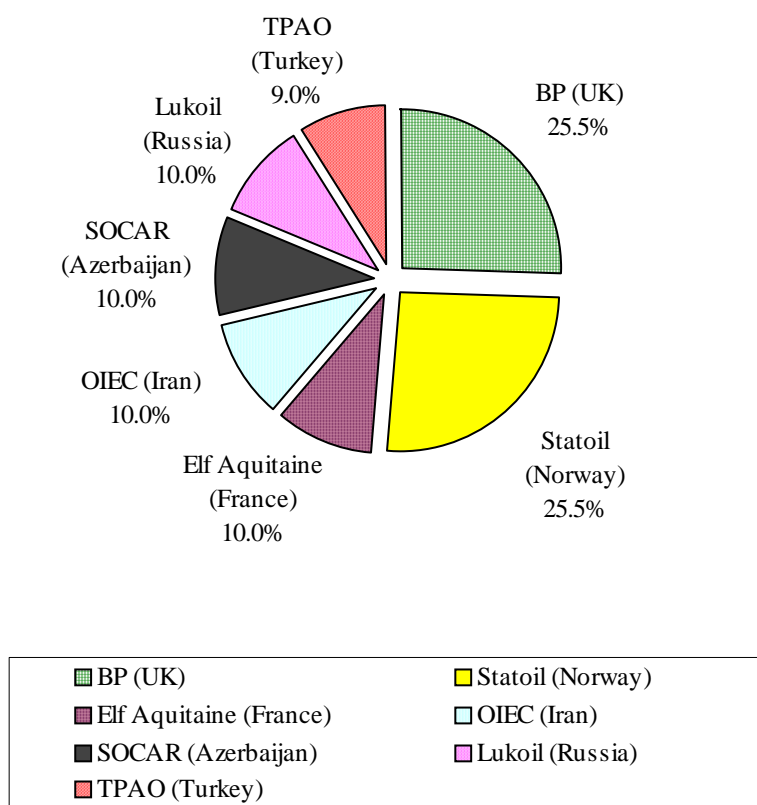
Table 2.1: Chronology of Major Oil Contracts in Azerbaijan*

Date/Status	Contact Field(s)	Contracting Company
Signed contracts		
August 1994	Karadag Structure, Kergez field	BMB Oil
20 September 1994	Azeri, Güneşli, Chirag fields	Azerbaijan International Oil Company
10 November 1995	Karabagh Structure	LukAgip, Pennzoil, Lukoil, SOCAR, Agip
4 June 1996	Shah Deniz field	BP, Statoil, TPAO, OIEC, Lukoil, Elf Aquitaine
7 June 1996	D-3, D-9/D-38 Blocks	Exxon
13 January 1997	Lenkoran Deniz, Talysh Deniz fields	Elf Aquitaine, SOCAR, Total
25 February 1997	Dan Ulduzlu, Ashrafi fields	Amoco, Unocal, Itochu, Delta
Contracts pending or under revision		
Under revision	Arazbashi, Zeinalabdin Tagive oil and gas blocks	Chevron
Under revision	Muradkhanli field	Pennzoil
Under revision	Kyapaz field	Lukoil

* Source: Agip

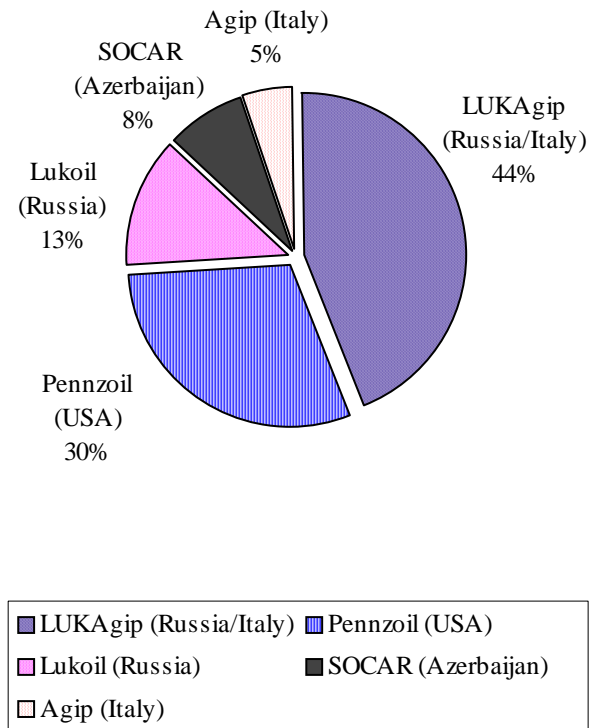
APPENDIX 3

Figure 3.1: Participating Interests in the Shah Deniz Project, July 1996*



*Source: SOCAR

Figure 3.2: Participating Interests in the Karabagh Project, July 1996*



*Source: Agip

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